

## PREFACE

This study is an investigation of the role of income taxation since the first imposition as a temporary measure till the modern reformative tool for social ends.

It contains three parts dealing with income taxation in Britain, the fiscal structure of UNIVERSITY OF EDINBURGH and what are its DEPARTMENT of POLITICAL ECONOMY.

The field of research is limited to the development of the existing income tax in Britain, Egypt and France.

### A COMPARATIVE STUDY of INCOME TAXES

in BRITAIN, EGYPT and FRANCE.

followed in the British footsteps but only after a long time of reluctance and hesitation. In Egypt the tax is a novelty in the

social structure. Thesis prepared for Ph.D.(Econ.) Degree Under the Supervision of Dr. M.L. Rankin and Professor A.G. Murray.

The subject is very wide and its development is in the hands of the statesmen and the countries, as no Minister of Finance can ignore such a factor in shaping his policy. The writer has done his best to follow the recent changes as he holds the view that the present-day progress should take first place in our attention as society cannot afford the luxury of mere intellectual arguments.

This study is written for A.M. HASSAN, B.Com.(Econ.) Fouad I University, Cairo. Dipl. Inst. Fin. Stud. Cairo. Egyptian Ministry of Education on behalf of Fouad I University, to



## PREFACE

This study is an investigation of the rôle of income taxation since its first imposition as a temporary measure till it became a reformative tool for social ends.

It contains three parts dealing with income taxation, as part of the fiscal structure in War and Peace; how it is technically conducted; and what are its impacts, incidence and social effects.

The field of research is limited to the development of the existing income taxes in Britain, Egypt and France.

Britain is the pioneer in imposing income taxation which has proved to be of great economic as well as social significance. France followed in the British footsteps but only after a long time of reluctance and hesitation. In Egypt the tax is a novelty in the social framework and some people are taking it as an "Aladdin's lamp" which can bring them everything they need and take them along the right path.

The subject is very wide and taxation development is in a dynamic state in the three countries, as no Minister of Finance can ignore such an important tool in shaping his policy. The writer has done his best to follow the recent changes as he holds the view that the present-day problems should take first place in our attention as society cannot now afford the luxuries of mere intellectual arguments.

This study is carried out mainly through an award from the Egyptian Ministry of Education on behalf of Fouad I University, to



whom the writer expresses his deep gratitude.

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1. Laufenburger, H: Finance Comparées, Annexes 1, and  
Inventaire de la VIII.ation Financière, p.44

## INTRODUCTION

1. The last forty years have seen a tremendous increase in the part absorbed by taxation out of the national income. In Britain this part increased from 7% in 1913 to 40% in 1951. This is in addition to what the local bodies impose in rates. In France the proportion increased from 14% in 1913 to less than 38% in 1951.<sup>1</sup> In Egypt, taxation is still in its infancy and amounts to approximately 10% of the national income.

Such high taxation in Britain has its significance. It embodies a far reaching effect of great magnitude upon the whole economy of this country and in one way or another on international economic relations. The taxes collected in Britain in 1950 were about half the figure of wages and salaries and nearly equalled the whole expenditure on food and clothing in that year. The importance of income taxes in the structure is clear from the fact that they made up about 50% of the whole tax revenue. The rate of taxation on the upper reaches of income stands at 94%, a rate beyond anyone's imagination a century and a half ago, when people of middle and high incomes during a time of emergency condemned the contribution of 10% as ruinous, disturbing the political as well as the socio-economic structure of society. What is more, high income taxation is accompanied by excessive measures of taxation in other directions which have no parallel in history and there is no prospect of any relief in the future. The impact of taxation

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1. Laufenburger, H: Finance Comparées, Annexes 1. and Inventaire de la Situation Financière, p.44

on the distribution of wealth and income and its influence on production and employment deserve much thought and careful analysis, for the repercussions are complicated and far reaching.

2.       The increase in the rate of taxation goes parallel to the increase of State expenditure, and, *pari passu*, State activity. It confronts us with a problem which necessitates decisive action. We have to decide whether to call increasing State activity to a halt, trusting that the individual is capable enough of dealing with the growing problems of life, or to let the new currents take their course as being the natural outcome of our economic development. If we agree on the first action, what assurances could be given that individual behaviour would lead to the maximum welfare of the public, which is generally accepted as a reasonable end, and that society could develop and effectively progress in our conflicting world. If, on the other hand, we yielded to the second course, how could we cope with the deep rooted traditions of individualism with its symptoms of competition and freedom of choice? And if this could be overcome, who could give an assurance that the decisions taken by the State would lead to the former end? It seems that we are faced with a peculiar and very awkward problem, as the issues involved are not only economic but also social and political with highly complicated features of domestic and international consequence.

3.       In our complicated affairs we have to be careful in drawing

conclusions and ascertaining results. For instance a negative correlation could be noticed between tax increases and the deterioration of productivity per man. But this is not a phenomenon from which one should make undue inferences. There are distinct factors that determine the trend of taxation and productivity. The gradual reduction in the purchasing power of money, the mounting expenses of the services run by the State, the growing of population and the tremendous expenses on war and its outcome, are factors attributed to increasing taxation. On the other hand, the development in Trade Unions' status with their pressure for higher wages and shorter hours of work without due regard to the prices of commodities and units produced in addition to the inability of a group of capitalists to renew their plants, have a marked influence on reducing productivity. That does not mean that taxation has no impact upon productivity. In fact it has, as we shall see later in this thesis. But the point to be emphasised is that the interrelation between taxation and productivity is rather a politico-social and economic phenomenon more than a directly economic one and has to be analysed accordingly for any accurate result. When the rate of taxation is excessively high this depresses the incentive to produce: there can be no doubt about that. But it is very difficult to visualise what could be done in a democratic system based on the possession by the masses of decisive power to vote for whoever they think satisfies



their demands.

4. High taxation may be an important problem, but it is not the main one. There are other problems of social and economic justice and there is after all the socio-economic development which has to be enhanced. This might not be impressive, in a highly developed country like Britain whose main worry now is to keep in order her balance of payments, but this is more clear in Egypt which is far behind other nations. In Britain and France high taxation is blamed for their economic difficulties. In Egypt the blame is placed on the low rates of taxation. Considering these two types of case, one might wonder whether there is, in reality, an absolute limit of taxation in relation to each one's position. Whether such a limit exists or not we will discuss later. But it seems quite clear that one cannot have development, under the conditions of the world to-day, without paying dearly for it. And society cannot attain a certain degree of economic equality amongst its members without someone being called upon to sacrifice for this purpose.

5. The politico-social development of the last two centuries has resulted in giving a concrete concept to the State. It is no longer considered as the will of the Sovereign, but rather as the tool through which people function. It is not only expected to restore order and defend the country from outside aggression, but also to look after the welfare of individuals, to attain full

employment and to realise a certain degree of equality in the distribution of the community's resources and products. Moreover, it has become the responsibility of the State to guard the interests of the unborn generations against the selfishness of the present one.

Small wonder then, that the broadening of the area of State functions necessitated the appropriating of an increased share of the nation's income and pressing demands on the individual. Appreciating the results of such development, the under-developed countries are following the same lead and no doubt will face the same complicated problems. Whether or not this is a wise procedure is very difficult to assess from a neutral basis and a value judgment is unavoidable. In our state of affairs, nothing can be termed perfect but one can choose between two given alternatives. If it were a matter of choice between two communities where one is highly developed with excessive taxation and the other is backward with low rates of taxation, the majority and the rational would choose the first one. This is in accord with the natural order of progress.

6. Different writers have looked at the development of taxation from different angles in their attempt to explain the changing Norm of taxation. Wagner, for instance, looked at it from the point of view of social development, noticing three eras; the feudal, the individual and the social. In the first one taxes

are imposed on certain classes; in the second, expenses of the State have to be distributed amongst the subjects without exception, and in the last, the burden is borne by those who are most able to carry it. Seligman looked at taxation from the evaluation of the faculty principle, in other words, the logical outlook of assessing the burden in a just way: from considering the individual he progresses to considering property and income as subjects of taxation. Another outlook on taxation is drawn from the position of the individual in relation to the State. In the 18th Century, Montesquieu, for instance, based his ideas on the social contract, and defined the tax as the insurance premium paid by the individual. In the 19th Century, Proudhon defined the tax as the part paid<sup>1</sup> by each citizen for the requirement of the State. The word compulsory is but new in defining taxation and this makes all the difference between light taxes largely on commodities and heavy imposts mostly on income and capital. It is thus considered as a compulsory contribution on those who are able to pay, irrespective of the amount of service rendered to them. Taxation was also treated from the viewpoint of justice and this sacrifice had to be taken into consideration. Adam Smith and J.S. Mill emphasised that equality of sacrifice on different basis. The former considered it to be attained if the individuals contributed in proportion to their respective abilities;<sup>2</sup> and the latter saw it when each individual should

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1. Formery, L: Les Impôts En France, Tom I, pp.10 et seq.

2. Smith, A: Wealth of Nations, McCulloch Ed. p.373.

"feel neither more or less inconvenience from his share of the payment than every other person experiences from his."<sup>1</sup>

Edgeworth being rather more profound in his analysis favoured the least aggregate sacrifice as the acceptable principle of taxation.

Most of these definitions as one can see, dealt with taxation from the point of view of the Statesman, rather than that of the taxpayer himself. The latter is not expected to be idealistic; he is more or less emotional and looks at the tax according to his mood. His conception of the State differs with his disposition or rather his social and political group. If one understands this point one can analyse individual reaction towards any specific tax.

7. It is very important to notice the peculiar reaction to any tax and how much reaction might have political, social and economic repercussions. In Britain when income tax was first introduced to finance war with France, some of its opponents went as far as to denounce war altogether if it justified such a measure. "If the continuance of the war was so indispensable" added another opponent "the tax should be upon landed property".<sup>2</sup> "Remove these great proprietors of boroughs and peace may be obtained" was a direct reaction to income tax which seemed at that time as out of the question and irrelevant to the problem. This is similar to what we are hearing now from the Socialist benches.

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1. Mill, J.S: Principles of Political Economy, p.805

2. Cobbet: Parliamentary History of England, Vol. XXIII, p.1082

In France the logic and persuasion of her Minister of Finance to impose income tax, did not stop severe attacks on it as oppressive, unconstitutional and a tool of tyranny in the hands of the Government.<sup>1</sup> In Egypt, the levying of the schedular income taxes was hailed by a large section of the public. The land-owners found in it the manna from heaven sent to relieve them from part of their burden. The nationalists considered the measure as a step forward towards the fulfilment of national aspiration. These controversial outlooks have their bearing upon the construction of any tax system and have to be taken into consideration whatever the study.

8. In spite of all the obstacles that were raised against income taxes and the objections to their imposition, they shortly gained great reputation on account of their flexibility for finance and became the backbone of most of the taxation structure of modern countries. Depression and war have provided testing grounds for income taxes and proved their accuracy. Normal conditions, on the other hand, have emphasised their importance and necessity.

Adopting the benefit of the service principle, De Marco holds the view that, assuming that the members of the community are all consumers of the general public service, each income is taken as an index for measuring their demand and accordingly, taxes have been fixed as a percentage of income.<sup>2</sup> Whatever the merits of

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1. Seligman, E.R.A: The Income Tax, pp.281 et seq.

2. De Marco, A. de Viti: First Principles of Public Finance, p.114.



such a view, the fact that the flow of income is continuous makes a Minister of Finance assured of a regular return which increases simultaneously with that of national income. Besides, income taxes are considered by their adherents as the means through which equal distribution could be realised; though others would not go as far as that and simply think that the superiority of such taxes over others is their neutral and unprejudicial effect on the individual.

9. In spite of the fact that income taxation sprang from one source, it took different shapes under different developed societies, because of the differences in their economic structure and the effect of the socio-economic forces in power. In Britain income taxation developed from the temporary one imposed as a war tax, later it was accepted as an auxiliary tax to meet the budgetary deficit and lastly as a main factor in the fiscal structure. The pressing needs of the last two wars called for the imposition of profits tax and excess profits tax which are merely income taxes of special kinds. In France, the imposition of the schedular income taxes and a tax on the general income was claimed to be a triumphant success after a century of fight against the guardians of the old system. As in Britain, other subsidiary taxes on profits were imposed and the income tax system became rather complicated. Income taxation was levied in Egypt just before the World War II as a result of the termination of the Capitulation, through which "foreigners" were exempted from all direct taxes

except the traditional ones on land and dwellings. In its short duration, it ran through the same channels as its counterparts in Britain and France.

10. It is true that the British Income Tax is the oldest of the modern types and it influenced the French authorities when they constructed their system. It is also true that the Egyptian income tax was a rough copy of the French one with some rules of the British and Italian systems. But this is not enough to make a comparative study of income taxes worth while. In any comparative study there should be a certain degree of uniformity underlying the different systems. This uniformity we find without difficulty in Britain, France and Egypt. The structure of the three nations is based on individualism, the parliamentary system, and on the acceptance of a certain degree of State control to organize the economic behaviour of the individual. They all accept the present pattern of society and respect private property and the acquired rights. There are certain differences among the three countries in their degree of economic development, and a consideration of such differences will be of great help in assessing the accuracy of any policy on production, distribution, and employment. From the experience of the three countries one might judge to what extent income taxation succeeded in playing the rôle it was intended to play.

11. This thesis is an attempt to give a clear picture of the existing systems of income taxes in Britain, Egypt and France, showing their mechanism and rôle in the national economy. Political controversy will be avoided as it has no end. But, in the meantime, one cannot avoid advocating certain measures, approving a certain alteration, or adhering to a certain policy. It is a fortunate or unfortunate part of the technique and art of public finance that one has to commit oneself to certain views and ideas. The writer is in complete agreement with what De Marco stated, that, in public finance one "has recourse to one's personal ideals of social justice".<sup>1</sup> This is the same trend followed by Simons who emphasised frankly that "to dissemble any underlying social philosophy and to maintain a pretence of vigorous, objective analysis untintured by mere ethical considerations" has become conventional among students of public policy.<sup>2</sup>

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1. Ibid, p.15

2. Simons, H.C: Personal Income Taxation, p.1.

CHAPTER IINCOME TAXATION in WAR TIME

There were three periods to cover the last three great wars in which income taxation played a notable part in their finance. In the first period, the tax was imposed in Britain as a temporary measure to finance the long war with France, and was suspended after the termination of that war.

PART IINCOME TAXATION in the FISCAL STRUCTUREin WAR and PEACE.

In the second period, World War I, income tax was in a perfect state in Britain after 72 years of its re-imposition. In this period France introduced her first modern income tax. By the third period, World War II, income taxation was the backbone of the British fiscal structure; France improved her system and Egypt introduced her own tax for the first time in history. During the last two wars a levy on the excess profits was introduced in every country which had an income tax. In most cases, when this extra tax had to come to an end, it was replaced by a moderate tax on profits.

The following is an analytical discussion of the rôle of income taxation in the last three great wars.

I. Income Taxation in the Anglo-French Wars.a. The dominating ideas of the time:

When war between Britain and France broke out in the last decade of the 18th Century, there were certain ideas and ideals dominating the financial system of Britain. Such ideas were also accepted in France with the difference that the Revolution gave them constitutional fixation. It was agreed on all sides that taxation should be impersonal in order

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to stem any prejudicial behaviour in its application. It should also be as little as possible and not go beyond what enabled the State to realise its essential functions. If more expenditure was needed, it should be met only by public loans. From the distributional point of view the maxims upheld could be summarised as follows: firstly, everyone was subject to taxation so long as they all shared in the common benefits furnished by the State: secondly, poor people could be exempted on compassionate as well as administrative grounds: thirdly, necessities should not be taxed if possible to prevent wages from rising to the detriment of trade and employment: fourthly, taxation should be brought to bear on expenditure rather than on income and property to comply with the principle of voluntary or optional subscription: fifthly, taxation based on direct assessment of income and profits should be avoided for the interest of investment and accumulation: and lastly, taxation should not contain any distributive criteria.

While the former principles were accepted in Britain and France, the latter country relied more on direct imposts than the former. This was mainly a result of the Revolution which adopted the Physiocratic philosophy emphasising the principle that taxation should be on the "produit net".

The main items of taxation in Britain at that time were customs and excise duties which supplied in 1792 about 70% of the whole State revenue, and the taxes on land, houses, windows, supported by others on

horses, coaches, servants, perfumery, dogs, etc. formed only about 15%.<sup>1</sup> In France, the main taxes were those on the estimated product of land and dwellings as well as the tax "d'habitation" which was a poll tax and considered as the price of the safeguard of the persons' human rights. These taxes formed two-fifths of those imposed by the Act of 1791. On the other hand a tobacco duty superseded other indirect taxes which were suspended by the Revolution.<sup>2</sup>

State expenditure in Britain before the French wars was concentrated on debt service and defence which absorbed 55% and 33% respectively and thus only 12% was spared for administrative and other necessary expenses.<sup>3</sup> In France, conditions were unstable and figures were inaccurate. This can be realised from the fact that only about half the tax expected was paid into the State coffers in 1792.<sup>4</sup>

b. The force of events and the imposition of Income Tax.

In the first part of the war between the two countries, British Chancellors of the Exchequer tried their best not to deviate from the former principles. But war pressure, and the increasing need for revenue obliged them to drop them one after the other in accordance with the degree of resistance of the tax-payers and the administrative and economic consideration. Land and property taxes were increased and

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1. See figures in Silberling, N.J: Quarterly Journal of Economics, Vol. 38, p.215.
  2. Allix, E: and Lecercle, M: Impôt sur le Revenu, pp.79 et seq.
  3. Silberling, op. cit.
  4. The Constituent Assembly, being affected by the oppression of the taxation department insisted on abolishing it. See Allix, op. cit. p.86.

those on articles of wide consumption were imposed to assure adequate flow of resources for war needs. No drastic measure was taken and loans were contracted to bridge the gap in the budget. In 1797, the Chancellor of the Exchequer found himself in an awkward position, with the expenditure increasing, the position of the enemy improving and no signs of a quick ending of the war. Total revenue increased only by £2.6 m. between 1792 and 1797, while expenditure expanded by £44 m. The Chancellor not only had to pay for the increasing war expenses but also for the gradual increase of the debt service which was augmented by over £18 m. in interest and capital.<sup>1</sup>

Under these circumstances, Pitt introduced his famous plan of "Triple Assessment" as a half-way measure between taxation of income and the traditional system which was based on consumption. The "Triple Assessment" as it was explained at that time was based mainly on, first, its ability to diffuse the burden as extensively as possible, second, its adequacy of being regulated as fairly and equally as possible without any indulgence in wide investigation of property, and lastly, its justice in excluding those who were least able to contribute.<sup>2</sup>

Pitt did not disguise his intention that the contribution would deduct a considerable sum from a large class of householders, whom he conceived to be both able and willing to pay.<sup>3</sup> This was the unavoidable course for the preservation of the people's existence and their security

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1. Siberling, *op. cit.*

2. Cobbet's *Parliamentary History of England*, Vol.33, p.1043.

3. *Ibid*, p.1067.

in the future. Pitt emphasised, and these necessary expenses could not be met by loans alone, loans whose interest would remain a heavy burden on future generations.

The tax was not easily accepted and the opposition were aware of the outcome if such a principle was approved. Nicholls considered the tax as being unjust because of its compulsory nature<sup>1</sup> and its being based on expenditure which was by no means proportionate to property. The tax, he added, was not expedient and was meant to crush the middle classes, while it could be more just if it were imposed upon the landed property. This critic went as far as considering the tax as unnecessary because the war was not necessary.<sup>2</sup> Hobhouse made similar allegations and condemned the impost for being assessed upon past rather than future expenditure, a principle which was defended as giving the most impartial evidence that could be obtained of the ability of each individual.<sup>3</sup> Other objections raised against the tax were its effect on preventing the diffusion of "that philanthropy for which the nation is justly distinguished"<sup>4</sup> and the difficulty of its administration.

The "Triple Assessment" or the "Aid and Contribution" Act" as it was officially known, divided the taxpayers into three categories, the first comprising those who paid taxes on their establishments such as carriages, men servants or horses; the second including those who

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1. Ibid, p.1080

2. Ibid, p.1080

3. Ibid, p.1085

4. Marginal income exempted was £60 a year; incomes between £60 and £200 enjoyed a reduced rate and a claim for family support was accepted.

did not keep such establishments but paid taxes on the assessment of their houses, windows, clocks and watches; the third category comprising the poor who paid taxes on their lodgings or shops. In assessing income through expenditure in such a manner, the principle of exempting marginal income and providing certain abatements, were preserved.

The yield of the tax was disappointing, it was only 44% of the amount expected. This disappointment did not weaken Pitt's resolve. In the following year he faced the Parliament with an uncompromising project, namely changing the basis of the tax and imposing it directly on general income as derived from its different categories. This was taken to rid the former system of its grave inequality and of possibilities of evasion, and to reach other sources of income which had escaped before and should justly be included. On the whole the new attempt was expected "to approach as near as circumstances will permit to a fair and equal contribution".<sup>1</sup> The rate of the tax was proportional, 10% out of the estimated national income after exempting the lower income groups in the old system.<sup>2</sup>

In Parliament, controversy was keen. Tierney commented that Pitt's project would put "a tenth of the property of England in a state of requisition - a measure which the French have followed in their career of revolutionary repine".<sup>3</sup> The defects of the proportional income taxation were explained clearly. It was stated that for the sake of

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1. Cobbet's Parliamentary History of England, Vol. 34, p.5.

2. Scotland enjoyed a reduced rate.

3. Ibid, p.22.



equity, rates of the tax should differ according to the source of income and its permanency and also according to its size. The basis of taxation was constantly discussed; whether it should be on expenditure, income or property or mixture of them all.<sup>1</sup> Hobhouse suggested that "the individual should be rated according to the property he possessed, the income it produced and the degree of expenditure, which his situation in life, the size of his family, or other considerations might demand".<sup>2</sup> Another critic even at such an early period of fiscal development, went as far as to demand the imposition of a capital levy.<sup>3</sup> The wide discussion brought out a very important forecast of the temporary nature of the tax and its limit. Sir J. Sinclair wondered if this tax could ever be got rid of once it was imposed and whether once the principle was established the whole property of the country would not in future be at the mercy of the government.<sup>4</sup>

(c) The Rôle which the Tax Played:

Income tax was imposed in spite of all the objections and was operative till the termination of the War. Buxton thought that the step was taken rather "too late to repair the laxity of earlier days".<sup>5</sup> The debt service swallowed a large part of a tax which was in fact largely evaded. But we must avoid facile criticism which may arise from not considering fully the possible courses of action available in the period which we are examining. The imposition of the tax could

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1. Ibid, p.24.      2. Ibid, p.25.      3. Ibid, p.76.

4. Ibid, pp. 76 and 77.

5. Buxton, S: Finance and Politics, Vol.I, p.7.

probably not have been accepted unless it had become clear that excessive sacrifices were needed to end a long and tedious war. Considering the politico-social conditions at that time the introduction of income tax was a very progressive measure. Nevertheless, the yield of the tax reached in 1800 about 88% of the amount of that revenue derived from the well established land and other assessed taxes. The yield of incometax reached the £10 m. target in 1807, and then the amount gradually increased up to £14.6 m. in 1815.

The tax had a marked success in reducing the budgetary deficit, and while it did not stop borrowing it stabilised the amount of debt contracted every year as seen in the following table:

Main Items of State Revenue and Amounts of Loans in £m.

Year *	Customs	Excise & Stamp	Land & Assessed Taxes	Income Tax **	Total Revenue	Borrowing
1792	4.1	10.2	3.0	-	18.9	31.0
1797	3.9	12.3	3.4	-	21.5	71.2
1798	4.7	13.8	4.6	-	27.2	57.6
1799	7.1	14.3	6.5	1.7	32.5	57.3
1800	6.8	13.2	5.1	4.5	33.0	58.5
1800 (4th Quarter)	2.4	4.0	1.6	1.0	9.7	13.1
1801	8.8	14.6	4.6	5.8	35.9	52.2
1802	7.7	18.7	5.3	3.3	38.5	54.7
1803	8.2	22.2	5.8	0.4	40.4	44.9
1804	9.5	25.0	6.0	3.7	48.1	42.2
1805	10.2	27.3	6.3	4.6	53.2	51.4
1806	10.8	28.4	6.4	6.2	58.0	48.2
1807	10.6	29.2	7.0	10.2	62.3	46.0
1808	10.3	30.4	7.6	11.4	65.2	49.2
1809	11.9	28.7	8.4	12.4	66.5	48.4
1810	12.4	31.3	7.7	13.5	72.3	46.5
1811	10.9	31.2	7.4	13.2	70.4	49.4
1812	11.6	28.9	7.5	13.1	70.2	55.0
1813	11.9	30.8	7.9	14.3	76.7	59.2
1814	12.6	32.2	8.0	14.5	78.0	54.7
1815	12.0	32.3	9.5	14.6	82.8	54.9
1816	10.1	30.4	7.4	11.8	69.9	46.0

Source: The Quarterly Journal of Economics, Vol.38, p.215

Silberling raised the point that taking the period when income tax was imposed, it proved to be a "much less important source of revenue ... than the excise and other duties". This seems to be a rather unfair judgment. It was clear that the yield of customs duties was gradually increasing till 1810 when it swung down. Such is understandable considering that the blockade and war risks restricted trade and were bound to cut the revenue from the duty more and more. The excise duties, the only outlay taxes that supplied the State with an increasing amount. However, the expectation of continuous increase of their yield was doubtful. In the last five years of the War the increase of the yield of excise and stamp duties amounted to only £0.9 m. or about 3.5% of the 1810 figure while the increase in income tax yield in the same period was £1.1 m. being 8.4%. The average State revenue between 1806-10 and 1811-15 increased by £10.9 m., £3.8 m., or 35% coming from income tax alone and only £2.1 m. from the whole outlay taxes. Land and assessed taxes supplied an ample figure, increasing from £3 m. in 1792 to £9.5 m. in 1815; but the prospect of any further increase was doubtful: firstly, because the rate reached 4 shillings in the £, a figure commonly accepted as being for emergency: secondly the tax was a redeemable rent charge: and thirdly, landowners were

dominating the Parliament and could not be asked to pay more while others were exempt.<sup>1</sup>

The productivity of income tax could be seen when its rate increased from 6 $\frac{1}{4}$ % in 1805 to 10% in the following year, when the yield jumped from £6.2m to £10.1m. Moreover, one has to remember the implications of maldistribution of the tax burdens if income tax was absent. The repercussions of abolishing the tax after war is clearly noticeable in the social disturbances and the financial hardship which followed that procedure. If the revenue from income taxation seems to be small, it should be remembered that the tax was new and passionately resisted by the taxpayers. Pitt himself argued that abandoning income tax and confining on consumption taxes to yield the requisite amount of revenue was not only impracticable, but would introduce "disturbing evils ten times more severe than those which are imputed to this measure".<sup>2</sup> Seligman paid a tribute to the tax in declaring that "there could be no doubt as to its success".

#### d. The Burden of the Tax and its Distribution:

The figures of national income given by Acworth<sup>3</sup> might give an indication as to the part absorbed by taxation in this early period of economic development, without our committing ourselves as to the accuracy of such estimates.

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1. Seligman, E.R.A: Income Tax, p.58.

2. Cobbet, op. cit.

3. Acworth, A.W: Financial Reconstruction in England, 1815-1822, p.136.

In £M.

Year	N. Income	Revenue from Taxation	%	Income and Land Taxes	%
1792	140	17.3	12	3.0	2.1
1814	335	67.4	20	22.6	6.7

This shows that while national income increased by about one and a half times, taxation increased only from 12% to 20% between 1792 and 1814. Such could be interpreted by the fact that the community was in its early stage of industrial development which necessitated encouragement without which progress would be stemmed and enterprising faculties would be depressed. Taxation from income and land, while increasing by more than three times, seemed to restore a balance with outlay taxes, preventing them from aggravating the conditions of the poor.

The value of incomes assessed under the five schedules was £178.6m or 53% of the national income if we rely on the former figure. That means about 47% of incomes were exempted. The distribution of valuation according to the schedules in comparison with 1949-50 was as follows:-

In £M.

Schedule	1815-1816	1949-1950
A	60.1	396
B	38.4	41
C	38.3	214
D	11.7	2540
E	30.0	6175 *
	<u>178.6</u>	<u>9366</u>

\* Includes income of weekly wage earners who count about two-thirds of the figure.

Source: McCulloch, op. cit. p.145 and Inland Revenue Report Cmd.8103



Income from industry and Trade, Schedule D, subject to income taxation was very small in this stage of economic development compared with that nowadays. The development of income from Schedules D and E measures the elasticity of revenue from income tax because income from Schedules A and B is largely inelastic and income from Schedule C is influenced by foreign conditions.

The serious defect of the tax was in its having a proportional rate and thus hitting income earners the more the less their income was. At that time, the just tax was considered to be that which leaves the individuals "in the same relative conditions in which it found them",<sup>1</sup> in other words it should be proportional.<sup>2</sup> Accompanying this defect was the widespread criticism that giving allowances for the poor and abatements for children would encourage laziness and multiply the number of children in poor families.<sup>3</sup> These criticisms led to the abolition of the abatements for children in 1806, increasing thereby the burden of the taxpayers with families compared with others. Despite these defects the imposition of income tax as an emergency measure for war was significant. Taxation and especially that on income was accepted for the first time to be superior to the incurring of a large mass of debt. Moreover, income taxation did not die by its repeal

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1. McCulloch, J.R: A Treatise on the Principles and Practical Influence of Taxation, p.141
  2. Ricardo, D: On the Principles of Political Economy and Taxation, p.184
  3. McCulloch, op. cit. p.419, and Malthus, T.R: An Essay on the Principle of Population, pp. 460-476

in 1816; it brought lively and historical discussions which revealed most of the controversy concerning the tax. It raised the problem of distributing the tax burden and the co-ordination in the whole fiscal structure.

During these wars France did not have an income tax. She was levying the four non-personal taxes which were first introduced by the Revolution and lasted with little alteration till 1917. These four imposts were: The real estate tax, the business tax, the door and window tax and the personal property tax. They were much superior to the others which existed during "l'Ancien Regime". But as they are not considered as income taxes, in the modern sense, we can pass over them to the rôle of income taxation in the second period, World War I.

## II Income Taxation in World War I.

### a. The Eve of the War:

The outbreak of World War I did not find Britain financially unprepared. Since the beginning of the Century her taxation system was progressing steadily towards perfection. The contest over the People's Budget affirmed the absolute authority of the Commons in the matter of financial bills. The public was alive to the implication of taxation on society's socio-economic structure and were well acquainted with the theories of equity in its distribution, which were debated in the election platforms. The differentiation of the rate of taxation according to the source of income had been in existence since 1907,

and "unearned income" was made to bear higher tax than the "earned". The imposition of an extra rate on the part of income calculated to be spent on non-essentials and luxuries was carried out by the Finance Act 1909-10 when a super-tax on the higher incomes was levied. Moreover, allowances for children were introduced. Even the taxing of the increment in land value had had a place in the Statute Book since 1911. Last, but not least, a balance between direct and indirect taxation had been well observed since Gladstone's well known simile of the two attractive sisters. The proportions were already 47% and 53% respectively.

Income tax became a corner stone in the fiscal structure. In 1913 it paid about 72% of the State expenditure on welfare and debt services and about 67% of those on defence.<sup>1</sup> In the meantime income tax absorbed only 2% of the national income, a fact which explains its bright prospects.

While Britain had a well established taxation system, that could bear any quick change without any serious economic or social disruption, France was suffering from her inelastic and inequitable regime. Direct taxation was based on the four old impersonal taxes which were designed to assess profit on income according to the outward signs in a way to cause the least contact with the fiscal administration. The system was carefully analysed by Truchy who stated that it was of a more suitable nature "for a nation of small proprietors, of manufacturers

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1. Statistical Abstract of the U.K.

and traders on a small or moderate scale, each one firmly entrenched in his land or in his shop, very jealous of his rights and looking on the State as an enemy".<sup>1</sup>

The four old taxes supplied only 24% of the French State revenue and the property tax by itself yielded 42% of the direct tax receipts compared with 22% from that on professions and trade, a clear indication of the rigidity and the inequality of the system.<sup>2</sup>

To change such a regime which had lasted since the Revolution and survived after another (of 1848) was not an easy matter. The majority of population was middle class and not proletarian<sup>3</sup> and the land owning power dominated the Parliament.<sup>4</sup> They all worked hand in hand to defend their individualism and privileges by every endeavour. There can be little wonder that the introduction of income taxation, similar to that of Britain, was resisted in spite of a French Minister of Finance claiming it to be the most just and the most efficacious compared with that of France.<sup>5</sup> Opposition to income taxation reminds one of what occurred in Britain when it was first suggested. Political opposition portrayed the tax as being disguised socialism and a weapon of tyranny. In

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1. Truchy, H: The War Finance of France, p.205.

2. Annuaire Statistique, France, 1939.

3. Haney, L: History of Economic Thought, pp.330 and 603.

4. In some cases agricultural profits were estimated at about 10% or even less of their real value. See Truchy, op. cit. p.226.

5. Caillaux in one of his speeches tearing the French system down, stated that "the land tax falls with crushing severity on the peasant:... the patients...give rise in practice to the most shocking inequalities; the door and window tax is a tax on air and light...." Seligman, op. cit. p.311.

reality, according to Jeze "the ruling classes with fierce selfishness opposed all fiscal reforms which would increase their share in the public burden".<sup>1</sup> But the persistence of Caillaux won for him an approval of income tax reform which was legislated for 1914 shortly before the outbreak of hostilities. It thus took France a century and a half to accept the principle of income as a real indication of faculty for taxation.

As to Egypt, she was in a pitiful position. The only source of direct taxation at her disposal were those on land and houses; no other tax could be imposed that might affect the "Foreigners" without consulting the Capitulary Powers. Even the customs duties were governed by a chain of Commercial Conventions and the rates of the duties could not be increased without approval by the signatories beforehand.<sup>2</sup> In 1913 the State revenue was £17.4 m., 32% of it was supplied by land and house taxes and other minor direct taxes, 22% was supplied by customs and excise duties and other small items of indirect taxes and the remaining 46% came from State Railways, Telegraph and Telephone as well as postal services, public domain, fisheries and profits on the money in circulation.

b. A period of hesitation:

In spite of the maturity of the British fiscal system, and its

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1. Quarterly Journal of Economics, Vol.35, p.192
  2. The Capitulation system and the Commercial Treaties will be explained more clearly in the second chapter.



capability to meet the new requirements of the War,<sup>1</sup> the Government was reluctant to take any drastic measure. There was the "Great Reservoir" as the income tax had been called since Gladstone,<sup>2</sup> and there was the total stock of wealth<sup>3</sup> which would enable the people to make a worthy sacrifice. For the first months of the War no decisive action had occurred on the fighting front,<sup>4</sup> but expenditure was running at a million pounds a day and this had to be financed by the peace budget. In the middle of November, Lloyd George intended to go to Parliament to ask for tax increases. Speculation was rife and the "Scotsman" reported on the morning of the budget day that possibilities of new taxes to be imposed immediately were being canvassed eagerly.<sup>5</sup>

The focus was on Income Tax which everyone expected to get the necessary money for war.<sup>6</sup> Lloyd George himself reminded his listeners that the tax supplied ample sums to finance the French, Crimean and Boer Wars and emphasised that taxing and taxing heavily was the only path in accordance with the honoured traditions set and hitherto maintained by Britain in such an emergency.<sup>7</sup> Outlay taxes are important to exact a share from the non-earning group but still they are precarious. Customs duties, for instance, however high their rates yield but only a limited proportion of the total revenue owing to the physical and economic

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1. Stamp, Sir J: Taxation During the War, p.1.

2. Ibid, p.10.

3. Ibid, p.11.

4. Hirst, F.W. and Allen, J.E: British War Budgets, p.21.

5. The Scotsman, 17.11.1914.

6. Stamp, op. cit. p.17.

7. Hansard, Vol.68, 1914, p.350.

restrictions occurring during the war. In the case of excise duties, their yield is affected by demand and the products which are highly demanded cannot easily be taxed without straining political and social relations. On the other hand dependence on loans creates different problems. Internal loans are limited by the distribution of the national income and also upon the propensity of a section of the community above the margin of subsistence, to consume and save. Reliance on loans does not reduce the tax burden but rather shifts it to the future generation. External loans in their turn have a repercussion on the balance of payments of the debtor country and influence the shaping of its economic structure for a time.<sup>1</sup>

In spite of all this evidence, the British Chancellor of the Exchequer was not keen to exploit the occasion and increase the levy on income.<sup>2</sup> In his first War Budget he simply doubled the rate of Income Tax in respect of only the last four months of the year,<sup>3</sup> with a similar addition to the super tax.

In his second budget his liberal attitude inclined him to leave the rate of income tax the same. These feeble measures as Hirst called them had a bearing on the high rate of taxation that followed and remained for quite a good time after the War. It was not until a change-over took

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2. Hirst, F.W: The Consequences of the War to Great Britain, p.

4. The British indebtedness for the first part of the War (to end on March 31, 1915) was increased by £458m. See Mallet & George: British Budgets, 1913-1921, p.49. 56

3. The effective rate for 1914-15 was 1/8 in the £ and for 1915-16 was 3/- in the £

place and a third War Budget was introduced in September 1915 that real steps were taken to finance the War largely by taxation. It can be said in defence of such policy that Lloyd George did not expect the War to be of long duration, or on the scale which occurred.

In France conditions were worse. The War did not hasten the execution of Income Tax reform; on the contrary it was postponed and the call for doubling the rates of the existing taxes was refused under the pretext of not frightening the people and lowering their morale.<sup>1</sup> It was only in the middle of 1916, after two years of the War, that some serious measures were taken to let income play a rôle in war finance.

Looking back to the state of revenue and expenditure, in this transitory hesitating period: Income Tax out-stripped its first estimate by about 12%, and the Super-tax by just less than 20%.<sup>2</sup> The total yield of Income Tax in the financial year was £69.4m or about 30% of the whole revenue and over 36% of the tax receipts. The realised increase in Income Tax in the same year was only £22m. compared with £333m. being the budgetary deficit or less than 7%.

In Egypt the outbreak of the First World War called for an increase

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1. Truchy, op. cit. p.188

2. Hirst & Allen, op. cit. p.41.

in expenditure and as the revenue was rather inflexible a deficit occurred in the 1914 Budget (the expenditure was £E21.3m and the revenue £E19.1m) and the Government had to draw on the reserve fund.<sup>1</sup> Fearing that this state of affairs might continue, the Government increased the rates of customs duties by 1% on certain articles after consulting the Powers concerned, and only for the duration of the war. The Government was also obliged to increase the rates of public services instead of taxing the war profiteers. The Government was thus able to balance the budget during the war and even to augment the reserve fund by exploiting to the utmost the measures in their hand and by drastically cutting the less urgent part of the expenditure.<sup>2</sup>

c. Full Scale War Finance:

The long awaited budget to meet the direct cost of the War arrived with McKenna. Expenditure was increasing rapidly to an average of £1.3m a day in the four months interval<sup>3</sup> and private spending was by no means checked and prices increased by August 1915 to over 34%<sup>4</sup> of those at the beginning of hostilities. The Chancellor of the Exchequer raised Income Tax rates by 40% and broadened the tax basis by reducing the exemption limit, cutting down the abatements and resetting the assessments under different schedules. Super-tax was also increased. The new measures

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1. The system of keeping a reserve fund for emergency was a dominant factor in Egyptian finance which lacked the necessary flexibility.
  2. The reserve fund reached £E4 m in 1915-16 and increased to £E12.4 m in 1918-19.
  3. Hirst, op. cit.
  4. Ibid, p.80.

were expected to raise the revenue by an amount equal to the total receipts of Income Tax in the pre-War period.<sup>1</sup> These measures were accompanied by a fiscal innovation namely the levying of a special duty in respect of profits which had been extraordinarily increased during the war. The Excess Profits Duty (E.P.D.) had no success. It was imposed for mere political reasons, and after much reluctance for fear of its check on incentive. A considerable part of it was refunded to the taxpayers after the War in spite of the inflating prices.

The flexibility of the British income tax system was quite apparent. Every year brought increases in the rate or modification of its application which yielded more revenue. The marginal rate, which was 1/3 in the £ just before the War, reached 6/- in the £ in 1918-19, an increase of about five fold, and the Super-tax which was only 6d in the £ on incomes over £5000 became a progressive scale with an upper limit of 4/6 in the £ when incomes exceeded £10,000. These two increases brought the highest rate of Income Tax to 10/6 in the £.

The E.P.D. was imposed on excess profits over and above either an estimated standard figure or the pre-War average. The tax was justified as being on the abnormal profits which could not be reached accurately by the ordinary income tax. Another idea was that such profits arose from people's sufferings, and that they were not the result of individual enterprise. The rate of the duty was first charged at 50% increasing

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1. Income Tax yield in 1913-14 was £47 m. and the expected increase was £47 m.



to 60% in 1916 and to 80% a year later.

The elasticity of these taxation measures can be shown by the following table which gives the estimated and the realised revenue from Income Tax and E.P.D. and their relation to the aggregate tax revenue.

In £M

Year	Income Tax		E.P.D.		Total Tax Revenue	
	Est.	Real	Est.	Real	Est.	Real
1913-14	46.0	47.2	-	-	160.0	163.0
1914-15	61.5	69.4	-	-	173.8	189.3
1915-16	116.4	128.3	6.0	0.1	265.7	290.1
1916-17	151.5	205.0	75.0	139.9	381.2	514.1
1917-18	224.0	239.5	180.0	220.2	543.6	613.0
1918-19	290.5	291.2	300.0	285.0	782.2	784.2
1919-20	354.0	359.1	300.0	290.0	898.6	999.0

Source: Financial Statements from 1913-14 to 1919-20.

From 1915-16 to 1917-18 the receipts of Income Tax exceeded the estimates by over 16% and that of E.P.D. by 38%. Income Tax provided in 1918-19, 36% of the tax yield and with the addition of E.P.D. the percentage becomes 73% compared with 30%, in 1913-14. The total receipts of Income Tax and E.P.D. in 1918-19, was over twelve times the pre-War figure, while the aggregate receipts of taxation generally was only 4.8 times.

In France effective measures to offset part of war expenses through income taxation were taken in the middle of 1916. A general tax was imposed at 2% on all incomes over 5000 frs.<sup>1</sup> The progressive

1. Nogaro, B: Effects of the War upon French Finance, p.82.

principle was adopted shortly after that and the maximum rate became 10% increased to 12%, six months later, and to 20% in 1918. This tax on general income based on the existing tax formula was rather ineffective and produced not more than 51 m. frs or about 7% of the 1914 figure of "direct taxes".<sup>1</sup> The logical procedure came in 1917 when the imposition of the *Schedular Taxes* broadened the scope of that tax. The *Schedular Income Taxes* replaced the old impersonal ones except that on real estate. These were composed of a set of imposts on income from different sources with variable rates from 3 $\frac{3}{4}$ % on agricultural profits to 4 $\frac{1}{2}$ % on those derived from industry and trade.

The attitude to taxation which arose in the middle of the War, accompanied by the fierce criticism of war finance, forced the French Government to impose a war profits tax similar to the British one. It was justified rather from the social angle than from the economic.<sup>2</sup> Its rate was made 50% and raised six months afterwards (in December 1916) to 60% on excess profits exceeding half a million francs. A year later, the rate was graduated from 60% on the excess profits ranged from 100,000 to 250,000 frs. up to 80% on profits exceeding half a million francs. A similar measure was also taken, for political reasons, and an "exceptional war tax" was levied on people of military age not joining the *Colours* except in certain specified cases. It was a type of a poll tax of 12 frs. in addition to 25% extra on the general income tax.

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1. To include taxes on Securities.  
 2. Cf. Truchy, op. cit. p.202.

The success of these steps was very clear since 1917 as is seen from the following table:-

	<u>In M. Frs.</u>					
<u>Revenue from:</u>	<u>1914</u>	<u>1915</u>	<u>1916</u>	<u>1917</u>	<u>1918</u>	<u>1919</u>
Old Property and other "direct taxes"	764	704	680	718	402	) 1359
New Income Taxes	-	-	51	254	547	
War Profits Taxes	-	-	-	209	578	
Outlay and Similar Taxes	2157	2104	2798	3425	3467	5828
Tax Revenue	2921	2808	3529	4606	4994	7859
Total State Revenue	<u>4549</u>	<u>4131</u>	<u>5252</u>	<u>6943</u>	<u>7621</u>	<u>13282</u>

Source: Annuaire Statistique, France, 1939.

The yield of income taxes doubled themselves in 1918 compared with 1917 but this was at the expense of the "old property taxes" which shrunk by almost the same amount. The main reasons for the ineffectiveness of income taxes could be attributed to different factors. In the first place an important part of French territory was occupied by the enemy,<sup>1</sup> causing an adverse effect on the national income and even when it was reclaimed after the hostilities ended it was in a deteriorating state. Secondly, the collection was lagging very much behind assessment. For instance, in the 1919 Budget, 42% of the tax on schedular and general incomes was delayed in delivery and only 46% of that part was recovered a year later.<sup>2</sup> In some cases, the taxation department unlike its

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1. The occupied area was estimated to have produced 70% of France's coal, 63% of her steel and 78% of her sugar. See Peel, C: The Financial Crisis of France, p.111.
  2. Annuaire Statistique, op. cit. p.212.

counterpart in Britain was apathetic in demanding payment and by their actions encouraged fraud and evasion.<sup>1</sup>

It was estimated that out of 23 milliard francs of interest on State and company dividend, only 3.7 milliards brought in tax. The most productive tax in the whole system was that on war profits which yielded an amount nearly equal to that supplied by the "new" income taxes. Its amount increased by about 177% in 1918 compared to the preceding year and it was more than trebled in 1919. The proportion of income and excess profits taxes in relation to the total tax revenue was 10% in 1917 and 22% in 1918 which indicates their inherent elasticity and their possible success if they were well administered.

The increase of taxation and the imposition of new ones are not sufficient to explain the full story of war finance. War expenditure was very high and only a limited part was met by taxation. But this part had a certain bearing on the price level and the future balance of the budget. Britain defrayed about 24.7%<sup>2</sup> of her expenditure from the beginning of the War up till March 31, 1919, through taxation, the main part of it as we have seen came from the Income Tax and E.P.D. France in its turn defrayed only 15.4% by the same means.<sup>3</sup> The loans contracted were thus less in the former country compared with the latter, with the result that debt service in Britain increased by about ten times at the

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1. Peel, *op. cit.* p.110, said that in Spring of 1919, the taxpayers as a whole had not generally received the demand notes for income tax relating to the incomes of 1917.
  2. Excluding the loans given to the Allies and Dominions.
  3. Quarterly Journal of Economics, Vol.34, p.171. ✓

end of the War compared with 15 times in France.

Regarding its relation to national income, the debt charge reached in Britain 12.9% compared with 32.2% in France.<sup>1</sup> Such a heavy burden kept the rate of taxation very high in the post War period especially in France.

d. Tax Burden and its Distribution:

It is clear that Britain abandoned the idea of judging income tax in isolation which was the common outlook in the French wars. The whole tax structure was undermined whenever there was a proposal of increasing certain tax or creating another. The balance between "direct" taxes and those on outlay in Britain was changed between 1913-14 and 1918-19 in favour of the former. The proportion became 79% in 1918-19 compared with 54% in 1913-14. Besides, some material direct and indirect benefits were granted to the groups in the lower strata through the increase of welfare expenditure (on education, old age pensions, public health, etc.)

In the case of France, an opposite policy was pursued. The proportion between income taxes and outlay taxes changed in the period against the former. Their proportion became 25% in 1918 compared with 26% of the tax revenue in 1914. Following his apologia, Truchy justified this proportion of outlay taxes in France as due to the comparatively lower income in France than in Britain, the difference in the income distribution, with income in France being more widely

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1. For the figures see Stamp "Wealth and Income of the Chief Powers" the Economist, 24.5.1919.



distributed and the long acclimatization of the public to the British system.<sup>1</sup> But these are insufficient to explain the exemption of State securities in France, a principle which had long been rejected in Britain and the under-valuation of certain incomes which he himself mentioned as demoralizing the taxpayer and increasing the possibility of evasion.<sup>2</sup> The French accepted the payment of taxation by securities at their par value while they were in fact depreciated, thus reducing the effective amount paid. Moreover, the proportional increase in prices tended to widen the gap between the different groups and would thus call for a higher percentage of income taxes compared with outlay taxes.

In Egypt the war finance disturbed the balance between the classes and widened the gap between the rich and the poor. While cotton growers and dealers, for instance, massed wealth through a sharp increase in the price of their product, the poor classes were still struggling to survive.<sup>3</sup> The yield of the "direct taxes" which were paid by the property section of the people, was stationary at £5.6 m, but the revenue from "indirect taxes" and public services, which hit the poor section harder than others, increased from £11.8 m, in 1913 to £22.7 m in 1918-19.

The burden of taxation in Britain increased more during the War

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1. Truchy, op. cit. pp.222-24.

2. Ibid, pp.226-27.

3. Cotton prices increased from \$12.01 per kantar in 1914-15 to \$87.81 in 1919-20 and to \$200 in 1920; in the meantime, it was estimated by Dr. Wilson of the School of Medicine that the family expenses of the poor classes increased by 179% by the end of the war while their earnings went up by 80% only. See Crouchley, A.E: The Economic Development of Modern Egypt, p.192, Department of Overseas Trade, Report on the Economic and Financial Situation of Egypt, 1919.

than that in France as one can see from the following table:-

	1913-1914		1923-1924	
	Tax in % of N. Income	Tax per Capita	Tax in % of N. Income	Tax per Capita
Britain	7½	£ 3.5	18	£ 9.6
France	10	3.7	15½	5.9

Source: Bowley, A.L: Some Economic Consequences of the Great War, pp.116 and 120.

In addition to the economic effect of financing the War through taxation, it had also the psychological effect of impressing on the people the reality of the burden and the responsibility towards the coming generation.

If one can use the effective rates of taxation, at the end of the War in Britain and France, everything being equal, to assess the degree of pressure on different income earning classes, it could be observed that the burden on the higher incomes in France was comparatively more than in Britain as shown in the following table:-

	<u>Rate in the £.</u>					
	Income			All Unearned		
	All Earned			All Unearned		
	£150	£600	£100,000	£150	£600	£100,000
	pennies					
Britain Actual	5.4	30.0	123.45	7.2	37.5	123.45
France "	1.59	10.47	47.49	12.52	15.7	49.95
Corrected	5.4	35.56	161.29	7.2	9.0	28.62

Calculated from the Report of the Royal Commission on the Income Tax, 1920, Appendices.

The pressure on incomes of middle size was slightly higher in France than in Britain. In spite of this in the case of the unearned incomes

the French tax was more severe on the lower and middle groups than in Britain. Also, people with family responsibilities had to bear higher burdens even if income was earned.<sup>1</sup> On the whole owing to better war finance in Britain, and the long experience of income taxation, the country was in a better position to maintain comparatively more stable socio-economic conditions than France which had to face a high degree of inflation and disturbing and unbalancing budgets.

### III Income Taxation in World War II.

#### a. Expectations prior to the War:

The outbreak of World War II did not take any one by surprise. Since the middle of the 30's Fascism was beating its drum and a clash seemed inevitable after Munich. A large part of economic relations was defined in the inter-war period and the fiscal structure of the Great Powers was consolidated. Liberal measures to meet a world wide conflict were insufficient and the planning of the whole economic structure became a necessity. The orthodoxies of supply and demand in contracting loans and of profit motive as influencing taxation limit in a war, were ruled out. On the whole the sequence of economic phenomena of war became very much clearer. The writings of Nicholson, Pigou, Keynes, Jéze and Aftalion - their analysis and criticism of the economics of World War I directed the war architects in Britain and France in the second war unlike in the previous ones. In Egypt this was not exactly

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1. In Britain for a family composed of three children no charge if their income was £200, but paid in France £1. 4. 0.

the case. Shortly before hostilities she had overcome political obstacles and introduced income taxation of the modern type for the first time in her history.

Comparative assessment of the different measures taken in this period by Britain, France and Egypt would be rather difficult. While Britain was in full scale war from 1939 till 1945, France surrendered after Dunkirk and became non-combatant till the landing in Normandy. Egypt was non-belligerent nearly all the time. These differences in the part played in the hostilities had their bearing on the scale and manner of fiscal policy. Still it is interesting to analyse these different policies to find out how income taxation functioned during this period.

Two stages can be found to relate the chronological events of military actions to fiscal policy. In each case the country acted either directly or was obliged to take measures in conformity with the policy of the occupying power. The first period ended with Dunkirk or the French surrender; then the second period opened to be closed by the end of the War. In each stage a certain degree of State expenditure was needed but the policies were not necessarily uniform. While admitting that such division is rather arbitrary, it will be seen that it will facilitate the discussion.

#### b. Taxation Measures in the First Stage:

Britain entered the War with a sound budget, after several years

with realised surpluses. Made alert by the political unrest in Europe, she started to move, and by the F.A. 1937 introduced a "National Defence Contribution" (N.D.C.) which was applied, with certain exceptions to trades or business including agricultural business and business consisting of the holding of investments or other property. It exempted from the tax certain public utility undertakings such as water, gas, electricity, and railways, and other income realised from profession or employment. The Taxable profits were those exceeding £2,000 <sup>1</sup> per annum and the rate was 5% if the business was carried on by a company or other body corporate and 4% if the business was carried on by a different way. <sup>2</sup> By the F.A.(1) 1939, most of the existing taxes were increased, and the marginal rate of Income Tax became 5/6 in the £. An "Armament Profits Duty" (A.P.D.) was also levied on profits arising from armament contracts. The rate was three fifths of the part exceeding the standard profit which was to be assessed in the same manner <sup>3</sup> as the war profits taxes. <sup>4</sup> No time could possibly be wasted as it had been in World War I. On the whole, according to Hancock, by 1939 "a broader and firmer conception

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1. Profits ranged between £2000 and £12000 enjoyed an abatement of one fifth. See F.A. 1937.
  2. Building Societies were favoured and were subject to an over-riding maximum of  $1\frac{1}{2}\%$  of the total profits before deduction of interest on loans from members of depositors.
  3. No revenue had in fact been collected from the tax as it was merged with E.P.T. in the first war budget some months later. Its real importance was its use as the basis for E.P.T. See Hicks, J.R. and others: *The Taxation of War*, p.91.
  4. Excess profits derived from other than the defined reason was not taxed such as those from investment. No deductions were allowed on account of liability to pay the Income Tax, N.D.C. or A.P.D.



of the purposes and techniques of war finance had established itself".<sup>1</sup>

The declaration of war brought in complete mobilisation of the national resources. With established traditions of past history in mind the theme of the war financiers was 'pay as you fight'; in other words financing the War by taxation and keeping down national debt. The Government did not need any stimulation to increase taxation and create new ones, neither did they wait to see the upward movement of expenditure or expect a quick and decisive battle. A tremendous increase of expenditure was expected and planning was carried out on the estimate of five years of war.<sup>2</sup>

The Government planned to take back by taxation most of the increase of income due to war, but it became clear that finance by itself would not do the intended job and win the War, so that side by side with taxation measures, economic control had to be effective and inflation, the paradise of profiteering, had to be checked. So, F.A.(2) 1939, further increased the existing taxes and imposed the Excess Profits Tax (E.P.T.) in place of A.P.D. It was modelled on the latter levy but was to apply to all the field of trade and industry generally as there was no further need to deal with armaments profits separately. The N.D.C. was left in operation but only as an alternative to E.P.T. and the taxpayer had to pay whichever was the higher. Income Tax became 7/6

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1. Hancock, W.K. and Gowing, M.M: British War Economy, p.10. One can justify all such precautions understanding that at that time Germany was spending about 23.5% of her national income on re-armament compared with 6.8% in Britain; Ibid, p.71.
  2. Ibid, p.72.

in the £ and the Surtax scale was stretched with a top rate of 9/6 in the £, making the maximum rate for income tax 85%. The E.P.T. was charged at 60% of the profits exceeding the standard amount after providing an overall allowance.<sup>1</sup> To lessen the pressure of the tax on production and incentive a relief could be granted if the plant incurred any loss in a subsequent year.

More drastic measures had to be taken in the following year to cope with increasing difficulties and to impress upon the people the gravity of the situation. The change of Government brought in Sir K. Wood who announced the increase of the E.P.T. to 100%, a step which was taken for political rather than economic reasons.<sup>2</sup> When this measure was taken it was feared that it would increase temptations to spend lavishly on wages, administration or other unnecessary items and might accelerate demand on consumers' goods. In addition to the increase of the E.P.T. Income Tax was raised to 8/6 in the £.

The different tax measures realised in the first two years of the War an increase of £67 m and £284 m or 16% and 67% of the Income Tax receipts in the pre-war period. These increases equalled 53% and 58% of the additions to the total revenue from all sources. It was a notable amount but not enough to deal with the widening budgetary gap. Britain was faced with a dilemma after the defeat of France and it

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1. This was £1000 for the joint stock companies and £750 for each working proprietor in case of business carried on by a partnership. If the business was carried by a joint stock company, the rate would be 6% of the paid up capital, but if carried by a body of corporate members, the rate should be 8% and for other business 10%.
  2. Pigou, A.C:4 Studies in Public Finance, p.158. ✓

became clear according to Hancock that "the surrender of the liabilities of economic classes in the interests of national war-making power was never seriously challenged".<sup>1</sup>

In the case of France, in the same period, one finds little difference. The country was more aware of the explosive situation in Europe than they were in World War I. A series of measures were introduced to provide for rearmament, and others to complete the reorganisation of the taxation machine. War Finance was approached even earlier than in Britain. This was clear in 1936 when an extraordinary budget was drawn for war and by 1938 the extraordinary expenditure reached about 30% of the ordinary.<sup>2</sup> Between 1935 and 1938 a schedular sur-tax was imposed at 10% and 36% on the concerns deriving their profits from trading with State departments, civilian or military.<sup>3</sup> That tax was made progressive shortly before the War (29 July, 1939) and based on the turnover tax to be graduated from 25% on the slice of benefit not exceeding 4% of the turnover figure and 100% on the profits exceeding 10%.<sup>4</sup> It was less harsh on traders and those working on commission.<sup>5</sup> When the War began, three laws concerning this tax were passed in three months. The enterprises were divided into two: those operated on State contracts would be subject to a rate which ranged from 25% to 100% of the profit if it exceeded 2% to 10% of the turnover figure, the

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1. Hancock, op. cit. p.86

2. Laufenburger, H: Les Finances de 1939 à 1945, La France, pp.25-6

3. Formery, op. cit. p.217. 4. Laufenburger, op. cit. p.81.

5. The maximum rate for the traders was to be reached when the profits were 20% of the turnover, and for the others 40%. See Laufenburger, H: *Precis d'Economie et de Législation Financières*, p.34.

second section embodied other concerns and were allowed a bigger margin.<sup>1</sup> This measure was in reality an attempt to limit profit margins rather than to tax war profits.<sup>2</sup>

Moreover, the Scheduler and the General Income Taxes were increased and their administration was largely improved. The tax on wages was collected at the source from January, 1940,<sup>3</sup> in a manner similar to the British "Pay as you Earn" (P.A.Y.E.) practice. The general income tax was freed from previous limitations and it became possible that the rate of progression might exceed 32% and the aggregate tax paid could be more than 50%.<sup>4</sup>

Whether these measures were enough to supply war needs could not be easily judged because of the swift end of hostilities with the Germans. In spite of that one can see how France followed her old traditions of relying on loans and outlay taxes for financing the War. The expenditure from 1st September 1939 till the end of August 1940 was 263.4 milliard francs,<sup>5</sup> and only 56.8 milliards, or just less than 21.6% were supplied by taxation.<sup>6</sup> The direct taxes and those on income amounted to 29% of that figure. This low percentage could be explained in the light of administrative inefficiency, the loopholes in the laws and the reluctance of the taxpayers to comply with their obligations, unlike the case of Britain where the Chancellor of the Exchequer's appeal for quick payment was heartily supported by the public.<sup>7</sup>

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1. Laufenburger, *Les Finances de 1939 à 1945*, pp.81-2.

2. Hicks, J.R. and Others: *The Taxation of War Wealth*, pp.153-4 and Laufenburger, *Ibid*, p.86.

3. Laufenburger, *Ibid*, p.81.

4. It should be remembered that the taxpayer, according to the French system had to pay the tax on general income over those paid on the different schedules.

5. *Ibid*, p.63. 6. *Ibid*, p.106.

7. See Hansard, Vol.360, 1939-40, p.52.



As to Egypt in the same period, conditions were different. Shortly before the War an Income Tax Reform was introduced after a long struggle against the Capitulation system.<sup>1</sup> The Reform was a copy of the French Schedular Taxes of 1917 with some modifications taken from the British and Italian systems. It was not accompanied by a general income tax as was the case in France and suffered from most of the defects of its French original. The assessment of income was carried out sometimes according to outward signs or estimated rental charges. The rates were very modest, reaching 7% as the maximum. It was expected from the Reform, in addition to redistributing the tax burden, to supply the Government with ample sums to pay for the increasing civil expenses and those military expenses required by the Anglo-Egyptian Treaty of 1936.<sup>2</sup>

When the war broke out, it appeared that Egypt did not participate but in reality she was the centre of Middle East operations. According to the Treaty obligations all facilities of supplies, manpower and finance had to be provided for the forces. The new situation increased State expenditure especially that of the army which had to be expanded from ££2.9m in 1937-38 to ££8.2m in 1939-40. In spite of all that, up till the entry of Italy into the War and the French collapse, the Middle East seemed to be rather quiet. No drastic financial actions had to be taken. Prices increased by 24% in 1940, compared with 33% in Britain

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1. See Chapter II of this thesis.

2. Expenditure to meet the Treaty obligations reached ££1.2m between 1939-40 and 1942-43. Statistical Year Book of Egypt.



and 32% in France.<sup>1</sup> The budgetary deficit was £E6.1m or 14% of the revenue in 1939-40 and was met by drawing on the reserve fund. But while that year was the first full year since the introduction of the "new" taxes, their productivity was noticeable; they supplied £E2.7m or 43% of the yield of the "old" property taxes. All the "direct" taxes supplied 23% of State revenue compared with 16% in the preceding year.

c. Taxation Measures in the Second Stage:

The second phase of the War was very harsh for Britain in the beginning, but was comparatively easier when Germany expanded her campaign in the East and America joined the Allies in the battle for democracy. State expenditure was rising high and the budgetary gap was widening. But still there was no panic and confidence could be felt from the steady fiscal actions taken and the determined measures introduced, tapping every source of revenue. In addition to the 100% E.P.T., other drastic actions were taken to keep the net effective income as low as possible. Income Tax standard rate became 10/- in the £, allowances and reliefs for earned income were substantially reduced,<sup>2</sup> and the wage earners were asked to pull their weight. Farming and market gardening up to a certain degree were categorised under Schedule D and thus became subject to taxation on real profits.<sup>3</sup>

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1. U.N.O. Statistical Year Book, 1948.

2. To appease married women and encourage them to participate in production, their personal allowances were increased.

3. If annual value of the farm exceeded £300.

Foreign capital assets were transferred to the Treasury on payment of Treasury Bills. All these measures were accompanied by a vast scheme of price control and rationing.

To soften the psychological effect on those whose allowances were reduced, it was stated that revenue from such reduction would be credited to the taxpayers and made available to them after the War, as Parliament might determine. A similar procedure was taken in the case of E.P.T. which was severely criticised for its disastrous effect on production. The borrowed capital directed to develop and expand production for war needs was regarded as working capital when calculating the standard profits.<sup>1</sup> Moreover, part of the produce of the 100% rate was treated as reserve to be made available for industrial reconstruction after the War.

Juggling between the sources of income to get more revenue, different proposals were submitted to the Government but some of them had to be turned down. For instance, a suggestion that an excess tax could be levied on earned and unearned incomes was refused because incomes could not possibly bear any more taxes. Also, a proposal of a service tax on essential amenities had to be turned down for fear of the reaction of individuals and prices.

It seems as if Britain had reached a state of full mobilisation of fiscal resources and that no more taxes could be easily levied.

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1. This concession did not apply to financial concerns which were considered as being in a different position.

This is clear from the yield of most of the taxes especially those on high income groups. The Surtax reached a stationary state in 1940 and only a slight increase could be expected from E.P.T. after the confiscatory rate. The slight increase in the yield was mostly due to the increase in prices. The increase in Income Tax yield could be also attributed to the same factor. But on the whole, income and profit taxes supplied in 1944-45, £1893 m. more than the amount supplied in 1938 and about 1.8 times the whole revenue in that year as shown in the following table:-

The Yield of Income and Profits Taxes  
in £ m.

	1938-39	40	41	42	43	44	45
Income Tax	336	392	531	775	1007	1183	1310
Surtax	63	69	77	75	75	76	74
E.P.T. & E.P.D.	1	1	74	248	348	468	475
N.D.C.	22	27	24	22	30	34	34
Total	422	489	706	1120	1460	1761	1893
Total State Rev.	1006	1132	1495	2175	2708	3149	3355

Source: Statistical Abstract of U.K.

In spite of the fact that the finance "ceased to be sufficient as the measure and motive power of economic mobilisation in war"<sup>1</sup> net taxation (taxation less subsidies) paid about 40%<sup>2</sup> of the Government expenses from 1940 to 1945 compared with about a quarter in the World War I. The "direct" tax payment supplied about 50% of the former figure.

1. Hancock, op. cit. p.47.

2. Calculated from figures in Ibid, pp.200, 201, 348 and 349.

As to France in this period, the occupation altered her fiscal outlook in accordance with her new obligations. War expenditure was largely replaced by occupation costs causing a slight reduction in the aggregate expenditure. Between 1940 and 1944 the occupation expenses were 49% of the whole expenses in the period.<sup>1</sup> In 1944 the total expenditures reached about three times those in 1939 compared with about five times in Britain which was in a complete state of war on more than one front. To keep pace with the mounting expenditure the income tax was radically changed. The "new" measures were not only adopted as revenue getters but also in order to have an influence on prices and the cost of living which were intended to be kept fairly stable.<sup>2</sup>

A national agricultural fund was introduced to be financed from the yield of some taxes on agricultural profits,<sup>3</sup> and was intended to improve the social welfare of the agricultural class and to attract people to return to land. More direct measures to keep prices down were taken; distributed dividends and other payments from profits either to the shareholders or the Boards of Directors of Companies were not allowed to exceed those distributed in one of the three years before January, 1940, with an increase of 8% of every increase in Capital. Moreover, the undistributed profits were blocked and could only be

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1. See figures in Laufenburger, *Les Finances de 1939 à 1945*, p.67.
  2. London and Cambridge Economic Service Vol.24, 1946, p.218. ?
  3. To finance the "Fond Nationale de Solidarite Agricole" several taxes were imposed; for instance a tax of 3% on the basic prices of the wheat production, 8 frs. on each hectolitre of wine produced, 3% on the selling prices of wood from forest, etc. See Laufenburger, *Précis*, op. cit. pp.19-20.



used by the Treasury at interest.<sup>1</sup> By the Act of January 1944, the maximum dividend and profits distributed were limited to 20%.<sup>2</sup> The schedular tax on interest was made uniform at a rate of 25%, except in the case of interest on post office personal deposits which was favoured (rate 10%). A Sur-tax of 5% was also imposed on most of the existing taxes.<sup>3</sup> Another measure taken was the replacement of the Armament Duties by a tax on excess profits in 1941, which exceeded either the basic profits of the pre-War figure or 6% of the working capital. The rate was progressive and varied between 25% and 80%.<sup>4</sup> The real agricultural profits of collective organisations became subject to schedular taxes in 1942, and the indirect system of assessment, "forfait", through which professional profits were estimated was changed in the same way.<sup>5</sup> The most significant of all alterations was the ending of the practice of deducting the schedular taxes when assessing the revenue for taxation.<sup>6</sup> Certain reserves were allowed as in the case of Britain for the renewal of machines and plants. Such reserves were to be multiplied by 1.25 for 1940, and gradually till it reached 2.20 in 1944 (1939 = 1). In addition allowances were given for technical development and scientific laboratories, these to be countered by an extra tax on those subject to commercial and industrial profits tax.<sup>7</sup>

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1. Ibid, p.235

2. Laufenburger, H: Finances Comparés, p.235

3. Ibid, p.14

4. Laufenburger, Les Finances de 1939 à 1945, p.86

5. Ibid, p.83.

6. Ibid, p.84

7. This tax was part of the turnover tax from which were exempted those with selling turnover less than 10,000 frs. See Laufenburger, Précis, op. cit. pp.33 and 34.



The high tax rates were accompanied by a large degree of evasion which was encouraged by the resistance movement as a sabotaging method against the Germans. This limited the effects of direct taxation. From 1st September 1939 till 31st December 1944, only 29.5% of the State expenditure was met by budgetary receipts.<sup>1</sup> Out of the 1931.1 milliard francs expenditure,<sup>2</sup> between 1940 and 1944, taxation supplied only about 25%<sup>3</sup>, of which the "direct" taxes alone subscribed 36%.<sup>4</sup> In comparison with the conditions of the World War I as shown in the following table, it seems that income taxation was still excellent as a flexible financing measure for emergency.

In Milliard Frs.

Period	1 Total Expen- ses	2 Normal receipts	2 in % of 1	3 Tax- ation	3 in % of 2	4 Income & other direct taxes	4 in % of 2
1.8.1914-31.12.1918	140	25	18	16	64	5	20
1940-1944	1931	550	28	489	89	175	32

Sources: Laufenburger, Les Finances de 1939 à 1945.  
L'Annuaire Statistique, France, 1939.  
Quarterly Journal, Vol. 34, p.174.

Dunkirk opened a new chapter in the War, and the Axis, repeating the traditional method of attack against Britain drove to the back door in the Middle East, and Egypt had to strain her economy to cope with this

1. Laufenburger, Les Finances de 1939 à 1945, p.77
2. Ibid, p.66
3. See figures: Ibid, p.130
4. See figures, Ibid, p.114.

development. Extraordinary expenditure increased and prices soared. To deal with the new problem a rather liberal attitude was taken, similar to that of financing World War I in Germany and France, i.e. through opening credit in the Central Bank and other commercial banks. The increase in State expenditure was met by increasing taxation very moderately. Commercial and industrial profits tax was increased by gradual portions reaching a maximum rate of 12% in 1942. A sur-tax on most of the existing taxes fluctuating between 1% and 10% was also levied. Another peculiar tax was imposed on the profits derived from dealings in cotton in 1942. It was meant to force the cotton dealers out of the market in order to allow the Cotton Commission to buy the material at the price fixed by the Government. The rate of the tax was 50% of the profits above 12% from the cotton trade and was applied without interference to the other existing taxes.

The most important step taken was the imposition in 1941 of the E.P.T. It was in the Belgian model, and charged on profits exceeding a standard amount of the pre-War level or equal to 12% of the income actually invested. The principle of progression was applied and the rate ranged between 20% on the excess profits not exceeding a quarter of the basic figure, and 50% on the excess profits exceeding one half of the basic figure. Two years later the rates were increased reaching 75% of the part of the excess profits over three quarters of the basic amount.<sup>1</sup>

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1. For Egyptian Income Tax Acts see collection published in Arabic by the Egyptian Ministry of Finance.

The Egyptian Government had no difficulty in meeting their expenditure and through their economy drive they realised a surplus nearly every year between 1940 and 1945. Taxation supplied about two thirds of the revenue and income and other property taxes provided an average equal to 23% as seen in the following table:-

Year	1 Expend- iture	2 Revenue	In <u>££ M.</u>		4 Income and Profits Taxes	4 in % of 2
			3 Taxation	3 in % of 2		
1940-41	42.7	43.3	26.3	61	9.0	21
-42	46.1	56.1	33.4	60	10.4	19
-43	56.6	66.8	42.5	64	18.0	27
-44	71.9	77.8	48.1	62	20.1	26
-45	82.1	87.7	56.5	64	19.9	23

Source: Pocket Year Book of Statistics.

The flexibility of income taxation is very clear. Its yield increased from ££2 m. in 1940-41 to about ££8 m. in 1944-45. Also the E.P.T. supplied an amount equal to 75% of the Schedular Income Taxes in the latter year.

#### d. The Burden of Taxation and its Distribution:

From the previous analysis one can see that the British system distributed fairly the burden of War expenses between war time and the future much better than France did. The obvious burden on the British people was the continuous dissaving, through the consumption of part of the capital assets equal to £1686 m. from 1940 to 1944.<sup>1</sup> In addition,

1. See National Income and Expenditure, Cmd. 7371.

industry was unable during the War to accumulate reserves for post-War reconstruction due to the confiscating rate of E.P.T. In the case of Egypt her direct burden was the accumulation of sterling balances which were the outcome of Allied expenses. The increase of these expenses from £E25 m. in 1939 to £E76.8 m. in 1943<sup>1</sup> without sufficient increase in production resulted in the increase of cost of living index by over three times its pre-War level.

The proportion of national income absorbed by taxation in the three countries can be seen in the following table:-

	N.Income	Net Taxation	%	Per Capita in 1938 prices	Year
Britain : £m.	4707	1014	22	£21.3	1938
	8355	2504	30	39.1	1945
France : Mrd.Frs.	376	63	17	Frs.3875	1938
	1300	273	21	5150	1945
Egypt : £E m.	166	26	16	£E 1.6	1938
	502	54	11	1.0	1945

Sources: National Income and Expenditure of U.K.  
 Laufenburger: Finances Compares Annexes  
 : Les Finances de 1939 a 1945, p.128  
 International Financial Statistics Vol.IV, No.9  
 U.N.O. Statistical Year Book, 1948.

From the former table one can notice that the rate of taxation in relation to national income increased in Britain and in France but to a less degree; in Egypt it decreased. In Britain, it seems that the safety maximum rate of taxation was reached according to the Physiocratic policy and was much exceeded according to Clark's estimations.<sup>2</sup> Per

2. Clark, C: The Economic Journal, December 1945, pp.371 and 389.  
 See also Chapter VI of this thesis.

1. Prest, A.R: War Economics of Primary Producing Countries, p.128

Capita, the net tax burden in Britain increased in 1945 (in 1938 prices) by about 37% compared with 33% in France. While the average burden in Egypt was getting lower, the low income groups in fact bore an increasing burden. Their income increased by less than 50% compared with a 191% rise in the cost of living. The higher income groups whose incomes were highly inflated bore a much lesser burden due to the limited increase of taxation on them.

The following tables give the tax incidence on different income groups in Britain and France before and after the War:-

1938-39

Range of Income £	<u>Britain</u> Total Income		Rate %	Range of Income Frs.	<u>France</u> Total Income		Rate
	Before Tax	After Tax £M			Before Tax Frs.	After Tax Mlrd.	
Under 250	2681	2676	0.2	100-50,000 (£287)	86.1	80.4	6.6
500 - 1,000	350	311	11.1	100,000 - 200,000 (£575-1150)	5.5	3.6	33.7
1000 and over	170	84	51.2	Over 1 m. Frs. (Over 5750)	7.1	5.3	25.9
Total	5107	4704	7.9		115.2	101.5	12.3

1945-46

Under 250	3565	3449	3.3	Under 100,000 (£208)	561.8	538.3	4.2
500 - 1,000	1140	833	27.0	300,000 - 500,000 (£625-1042)	70.9	50.6	15.8
2,000 and and over	600	246	59.0	1 M and over (£2084 & over)	21.4	14.0	34.6
Total	9215	7358	20.0		880.7	801.1	9.1

Sources: Annual Abstract of Statistics No.84, p.232.  
 Brochier, H: Finances Publiques et Redistribution des  
 Revenues, p.44



The tables show that the lower income groups were still hardly hit in France compared with Britain. The part of income absorbed by direct taxation while it was reduced in France by about 27% between 1938-39 and 1945-46, was increased by over 153% in Britain. There are no figures available in Egypt related to the distribution of income that could be compared with the former ones.

importance in the fiscal structure; and in the third, it was used to implement certain socio-economic purposes. In Egypt and France the tax was levied from the beginning to reform the existing system, and so it did not pass the first stage.

#### I. Income Tax as a Temporary Measure to Balance the Budget.

After the abolition of income taxation in 1816, the British Chancellors of the Exchequer returned to the traditional measures of financing their budgets. Customs and excise duties were used to the utmost and land and house taxes supplied a limited and static amount. Ricardianism and "laissez-faire" ideology were dominating socio-economic thought. The current opinion was that State activity should be restrained and that the State should refrain from interfering with people's activities directly or indirectly, in order to achieve a maximum of welfare for the whole. This was justified under the assumption that State expenditure was unproductive and, therefore, that any increase of taxation would hamper production and curtail capital accumulation. Taxation was looked at as a choice of evils under every form.

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1. Ricardo, B; op. cit., p. 11.

## CHAPTER II

### INCOME TAXATION IN PEACE FINANCE

Income taxation in Britain has gone through three stages. In the first place, it was imposed as an emergency measure to balance the budget; in the second it became a permanent feature of special importance in the fiscal structure; and in the third, it was used to implement certain socio-economic purposes. In Egypt and France the tax was levied from the beginning to reform the existing systems and so it did not pass the first stage.

#### I. Income Tax as a Temporary Measure to Balance the Budget.

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1. Ricardo, D: op. cit. p 184

It could not be expected then that the purpose of taxation would be more than a fiscal one. Ideas of graduation and differentiation were unacceptable from both the economic and the moral point of view.<sup>1</sup> In the former it would mean an intervention leading to a disturbance in the price mechanism,<sup>2</sup> a circumstance which it was feared would paralyse industry. In the latter, such a policy would be unjust, violating the natural order in society.

Guided by these principles, the Chancellors of the Exchequer managed to reduce expenditure by about 40% between 1817 and 1836.<sup>3</sup> But this policy could not be maintained any longer than that since the debt charge was stationary at a high level and made up between 50% and 60% of the whole expenditure. The reliance on optional taxes limited revenue and cumulative budgetary deficits could not be avoided. Deficits occurred in twelve of the seventeen years prior to that in which income tax was reimposed, the total deficit for those twelve years amounted to £19.7 m and the surpluses in the other five years amounted in toto to only £5.3 m. Such a deficit had to be met by creating new deadweight loans, which, in their turn, aggravated the budgetary problem. In the period between 1816 and 1842, there were violent fluctuations of demand and employment, accompanied by bad harvests. The distress was felt by every section of the community and each attributed it to a defect in

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1. McCulloch, J.R: A Treatise on the Principles and Practical Influence of Taxation and the Funding System, pp.122-4.
  2. Ibid, p.141 and Ricardo, op. cit. p.184
  3. See Rees, J.F: A Short Fiscal and Financial History of England, 1815-1918, pp.28 and 54.

one part or other of the fiscal structure. The agriculturalists blamed high rates and export duties for aggravating their conditions; the industrialists laid the blame on high tariffs for preventing the recovery of industry; and the working classes were discontented with the extensive pressure of indirect taxes. Different propositions were offered from time to time to end the financial weaknesses but most of them evaded any reference to "direct taxation" of income. A general tax on houses, a property tax limited to capital and a levy on created wealth were some of these suggested imposts.<sup>1</sup>

The most urgent problem facing the Chancellor of the Exchequer was the chronic budgetary deficit which could not be cured by economies in expenditure. Balancing the budget was the main aim of sound policy at that time and one which was hailed from the economic and moral points of view. It was a sign of economic stability analogous to the behaviour of individuals. So Peel went to Parliament reminding it of its assurance to approve direct measures "for the purpose of equalizing revenue and expenditure".<sup>2</sup> The experiment of loans proved to be insufficient, wretched and inexpedient.<sup>3</sup> As to increasing outlay taxes, it seemed that such a policy was tried and failed to supply what was estimated, thus giving an impression that the rates had reached the maximum limit. Moreover, any increase of duties on articles of wide consumption would inflict excessive damage on the labouring classes and the duties on

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1. Seligman, E.R.A: The Income Tax, pp.118-121✓

2. Hansard, Parliamentary Debates, Vol.61, 1842, p.431

3. Ibid, p.430

luxury goods would not yield an impressive amount. Besides, such levies would depress industry and trade. Great initiative was needed to deal with the problem, and in spite of the resentment against direct income taxation, Peel proposed that "for a time to be limited, the income of (Britain) should be called on to contribute a certain sum for the purpose of remedying this mighty and growing evil". And so Income Tax was imposed for three years, bearing a rate of 7d in the £ on incomes ~~and~~ over £150 which was the exemption limit.

Foreigners, as well as nationals, were subject to the Income Tax, but Ireland for the time being, was not subject to it for no reason other than the absence of suitable machinery for the job.<sup>1</sup> One of the advantages of the tax, declared Peel, was the small cost of its collection.<sup>2</sup> The tax was criticised in Parliament for being the most unpopular levy ever introduced in Britain, inquisitorial and unjust. The opponents pressed the Chancellor to give an assurance that the tax would be temporary, that during this period of its temporary imposition its pressure should be light and that there should be no invidious exemptions, discrimination or graduation.<sup>3</sup>

The tax turned out to be more productive than had been anticipated and it yielded over £5 m. which was one-third above the estimated amount.

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1. According to the Irish, the Act of the Union which was passed in 1800 regarded them as a separate unit for purposes of taxation and thus were not obliged to subscribe in the U.K. budget of. The Report of the Royal Commission on the Financial Relations between Great Britain and Ireland<sup>c</sup>8262.

2. Hansard, op. cit. p.445.

3. Ibid, pp.508-9.



In 1844, a budgetary surplus was realised for the first time in six years.<sup>1</sup> This budget continued to show a surplus until 1854, with the exception of two years.

a. The Role of Income Tax to Reform the Fiscal Structure:

In addition to meeting the budgetary deficit, the Chancellor of the Exchequer intended to use the temporary tax to reform the fiscal structure. The Chartist movement was strong and the Anti-Corn League was very active. A Committee on Import Duties presented a report in 1840 in which they advised the removal of some prohibitive duties and the relaxation of others.<sup>2</sup> Peel and his followers did not doubt the social and economic advantages of implementing free-trade policy. The reduction of outlay duties would reduce the prices of articles of consumption and so the cost of living. Thus, the imposition of Income Tax, Peel asserted, would not mean an increase of the taxation burden because, from the pecuniary point of view, it would be compensated by a reduction in outlay taxes.<sup>3</sup>

The success of the income tax facilitated the continuation of such a policy, and thus its renewal became necessary at every date of the expiration of the temporary legislation. In 1842 export duties on home manufactures were removed except those on raw materials needed by industry such as coal and wool; other duties on no less than 750 articles were reduced.<sup>4</sup> By 1845, being in a strong financial and

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1. Cf. Rees, op. cit. pp.54 and 82.

3. Hansard, op. cit. p.439

2. Buxton, S: Finance and Politics, Vol.I, pp.48-50, The Committee showed that ten-elevenths of the whole customs receipts were produced by 82 articles; and over six-sevenths from only 9 articles.

4. Hansard, Vol.126, 1852, p.1359.

political position, Peel was able to sweep away by one action about 520 customs duties, most of them unremunerative, and so gave a great impetus to commercial enterprise.<sup>1</sup> A year later, the Corn Laws came to an end and the champions of free-trade were greatly strengthened. In 1853, Gladstone stated bluntly that Parliament could dispose of the income tax, but they had to find an alternative in a tax upon land, houses, and other visible property or in a system of licences upon trade, or by changing the legacy duties, none of which proposals could be as effective as the income tax, which was still needed to stabilise the budget and assure commercial and fiscal reforms.

The renewal of income tax this time, in spite of its unpopularity, was so important to finish the work which was already started that, according to Giffen, "Had no decisive remissions been made in 1853, had not the way to do so been discovered notwithstanding every obstacle, it is altogether doubtful when they would have been made."<sup>2</sup> It was in 1861 that Gladstone showed that a balance between "direct" and "indirect" taxation should be attained without any kind of partiality. In his financial statement he compared the two kinds of taxes as two sisters "one living more free and open, and the other somewhat more shy, retiring, and insinuating".<sup>3</sup> There was no need for unfriendly rivalry in the admirers of the two.

The tariff reform measures proved to be successful. While facilitating

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1. Giffen, Sir R: *Economic Inquiries and Studies*, Vol.I, pp.238-9

2. *Ibid*, pp.238-9

3. Quoted by Seligman, *op. cit.* p.165

trade and encouraging industry, they did not seem to have reduced the yield of customs and excise duties on the average.<sup>1</sup> On the other hand, the flexibility of income tax showed its merits as an engine of fiscal reform<sup>2</sup> and long experience strengthened its permanency. The Chancellor of the Exchequer in a short time became accurate in estimating the revenue from the income tax within a margin of error of 2.1% over 17 years, as one can see from the following table. This countered the criticism that the tax could not comply with the maxim of certainty.

Estimated and Realised Revenue from Income Tax  
in £ M.

<u>Year</u>	<u>Estimated</u>	<u>Realised</u>	<u>Year</u>	<u>Estimated</u>	<u>Realised</u>
1858-59	6.1	6.7	1867-68	6.8	6.2
1859-60	9.9	9.6	1868-69	8.7	8.6
1860-1861	10.9	10.9	1869-1870	9.4	10.0
1861-1862	10.4	10.4	1870-1871	6.4	6.4
1862-1863	10.1	10.6	1871-1872	8.8	9.1
1863-1864	8.7	9.1	1872-1873	6.9	7.5
1864-1865	7.8	8.0	1873-1874	5.6	5.7
1865-1866	6.2	6.4	1874-1875	4.0	4.3
1866-1867	5.7	5.7	Σ	132.4	135.2

Source: Buxton, Finance and Politics, Vol.II, App.C.

In spite of that, with an adequate surplus in hand, Gladstone thought that time had come to abrogate the tax, and made this the main plank in his election platform in 1874 but his defeat put an end to all hesitation and the tax became a permanent part of the fiscal structure of Britain. The reduction of the rate after the election to 2d in the £ was merely a political manoeuvre but no Chancellor of the Exchequer ever promised again to abolish income tax.

1. Cf. Rees, op. cit. pp.232-3.

2. Giffen, op. cit. p.245.

b.<sup>1</sup> The Distribution of the Income Tax Burden during the period:

The imposition of income taxation changed the balance between "direct" and "indirect" levies. In 1842, customs and excise duties yielded 74% of the whole State revenue; in 1875 when the income tax was at its lowest the percentage was 62%. In 1857, when the income tax revenue reached its highest figure of £15 m, the percentage was only 57%.

When the tax was introduced in 1842, the rate was 7d in the £; incomes under £150 were exempt, as were also savings banks and charitable institutions. Scotland enjoyed a reduced rate and the Irish were untaxed.<sup>1</sup> The outcry against the inequality of the tax resulted in an attempt at successive reduction of the rates after 1853, on diminution of the marginal untaxed income to £100 and the application of the tax to Ireland in the same manner as in Scotland. The Crimean War in 1854-5 pushed the rate up to 1/2 in the £, but then it was reduced again and fluctuated according to the need of the Exchequer and reached its lowest rate in 1874 when it became 2d in the £, a rate which could not be maintained without sacrificing the reputation of the tax that it costs least to administer. Sometimes, the low rate was accepted as a measure to lessen the inequality attributed to the tax.

The continuous criticism of inequality in the income tax resulted in the setting up of two Select Committees in 1851 and 1861 known as

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1. Seligman, op. cit. p.132. ✓ According to the Commission of the Financial Relations, op. cit. income tax was imposed on Ireland in compensation for a loan supplied to relieve the Irish poor during the Irish famine.

the Hume and Hubbard Committees, to enquire into the existing mode of assessing and collecting the tax and rendering it more equitable. The reports of the Committees threw much light on the awareness of the witnesses of the problems concerning income taxation at that early time of its trial. The actuarially minded witnesses favoured the capitalization of income by which method the tax could be assessed accordingly.<sup>1</sup> This seemed perfect from the theoretical point of view but presented such serious practical difficulties that Hume's Committee refused it, and it was also criticised by Gladstone in 1853.

The main problem, on which the two Committees virtually agreed, was the differentiation of the rate according to the kind, or the source of income; whether it was professional, or industrial, or variable, or ephemeral on the one hand, or what could be called perpetual, or certain, or property income on the other.<sup>2</sup> But neither was able to present a practical scheme to implement such a rule. The most objectionable principle was the graduation of the tax. In 1842, Lord Brougham objected to its application, arguing that it would destroy the basis of justice on which the tax was supposed to rest.<sup>3</sup> If one accepted the principle of graduation, the logical consequence would be a rate of 100% which could not be approved. McCulloch called such a proposal "seductive, unjust and dangerous".<sup>4</sup> If the State agreed to it,

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1. McCulloch adhered to this view. He said that in order to lay the same burden on two parties, we should calculate the present value of the income enjoyed by each. *op. cit.* pp.128-9.

2. Seligman, *op. cit.* pp.145 and 161-2.

3. Hansard, Vol.61, 1842, p.735.

4. McCulloch, *op. cit.* p.141.



he said, it had stepped out of its proper province, security would come to an end, and we would find ourselves "at sea without rudder or compass".<sup>1</sup> The two Committees failed to submit an approved report to reform the income tax as it was felt that the tax was of a temporary character and any agreed plan might result in making it permanent. Thus the absence of discrimination according to the source and graduation of the rate of the tax resulted in the burden being inequally distributed. In spite of the failure of the two Committees, they clarified some points concerning the income tax such as the exemption of savings which was advocated by J.S. Mill; the need for a clear definition of taxable income, the distinction between income and capital gain and the emphasis that net income and not the gross, should be the basis for the imposition of the tax.

The application of the income tax on Ireland, and the comparatively low rate enjoyed by Scotland raised the problem of distributing the Imperial tax among the different communities within the country. In less prosperous sections, the productivity of capital is smaller than in the prosperous ones in the same way as small incomes and high incomes are.<sup>2</sup> Accordingly, as we should graduate the tax rate to ensure equality of the distribution of the burden, the incomes of persons in less prosperous areas should enjoy a reduced rate. Such action would retain within the boundaries of the latter areas the capital necessary for its development. To what extent the distribution of the tax burden in the

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1. Ibid, pp.142-3

2. Royal Commission on the Financial Relations, op. cit.

period conformed with that principle is very difficult to assess. The O'Connor Don Committee which reported on its inquiry into the financial relations and the relative taxable capacity between Great Britain and Ireland in 1896 came to the conclusion that "whilst the actual tax revenue of Ireland is about one-eleventh of that of Great Britain, the relative capacity of Ireland is very much smaller and is not estimated ....as exceeding one-twentieth". The Report went on to quote N. Senior that "the pressure of taxation will be felt most by the weakest part of the community"<sup>1</sup> and that the capacity of a rich country for bearing taxation, relatively to that of a poor one, exceeds the ratio given by their respective annual wealth. In other words, the proportional rate of income taxation between rich and poor communities is bound to inflict excessive burdens on the latter compared with the former.<sup>2</sup> No similar enquiry was made about Scotland, but most probably, what is applied to Ireland can be applied to Scotland too.

Giffen, in an article written in 1876, looked at the problem from the angle of Parliamentary representation. He assessed that there "ought clearly to be some proportion between the representation of different communities in a common Parliament and the wealth and population of these communities".<sup>3</sup> Following his argument one would be led to accept a principle that proportional representation ought to be in accordance with taxation, to assure political stability. This is

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1. Ibid, p.16.

2. According to the Report the average income of the inhabitant of Great Britain was £40 and of Ireland £16 and after providing for subsistence, the proportional taxation would then take from the Irishman nearly three times as much comparatively as from an inhabitant of Great Britain. Ibid, pp.20 et sep.

3. Giffen, op. cit. p.277.

because, when disproportionality existed, the weaker communities share in voting the burdens which their richer and stronger associates have to bear. It is rather difficult to accept such a view as it would lead to the deterioration of the conditions of weaker communities. As in the case of individuals, communities should bear the burden according to their ability, assuming that the good of the whole as such is the end. The per capita figures would show that they were lower in Scotland and Ireland than in England, but this would not be sufficient indication as to the real burden in each section under the former assumption.

## II. Income Taxation as a Permanent Feature in the Fiscal Structure - A Neutral Stage (1874-1906):

The success of income tax as an emergency measure gave the Exchequer in Britain an accurate factor with which to construct a stable fiscal structure. He benefited from the theoretical discussions, the parliamentary controversy as well as from the different select committees which co-operated to clarify the nature of the tax. In Egypt and France, the task of the Ministers of Finance was different and rather difficult. They had to deal with a rigid structure, fortified by strong political power groups. Odd taxes on certain types of income were introduced and it was only after a hard and ceaseless struggle that complete systems of income taxation were adopted. Even then, these countries' reaction towards the "new" schemes was uncertain, making the estimates of the Ministers more or less, uncertain and hazardous.

### a. Gradual Increase of Expenditure:

Several factors contributed to the gradual increase of expenditure

in the three countries, in spite of the economic tremors from time to time. Population was growing steadily and their needs were increasing sharply. The international instability necessitated the maintenance of a large standing army and a high rate of rearmament. There were also war commitments which contributed excessively to the charge. Moreover, expenditure on social welfare was augmented, an outcome of a revaluation in public sentiment and political thought. In Britain, State expenditure increased by £33.9 m. or 45.6% in the 25 years between 1875 and 1899. The Boer War pushed expenditure further up and the return of peace did not return it to its pre-war level. In Parliament, members disputed the wisdom of such a course of affairs and argued whether such an increase was proportional or "out of all proportion to the national enrichment".<sup>1</sup> The same steps, but on a smaller scale, were followed in Egypt and France.

The increase of expenditure in Britain did not come about without resistance. In 1904, an amendment tabled to the Finance Bill condemned its continuous growth and all aspects that led to such an increase were attacked. Administrative expenditure were considered as of a wasteful nature. Expenditure on social services was not favoured by one section and those on army and navy were condemned by another. Even the discharging of the public debt through a "sinking" fund was painful. Its maintenance meant a high rate of taxation and its suspension meant a large debt service. It was feared that an unchecked increase in public

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1. Cf. The discussion in the 1902-3 budget and controversy of W. Churchill and Sir R. Giffen in Mallet: *British Budgets*, pp.193-4.

expenditure would "broaden largely the basis of taxation (and) would therefore raise ...something much more formidable than a political issue; it would raise an issue directly social".<sup>1</sup> This fear was justified shortly afterwards when the socio-economic aspect was dominating the taxation policies - an expenditure which started in Britain and spread to other countries. Harcourt declared in 1895 that this trend would be permanent. He frankly said that "economy...has become a lost art at the close of the century. It is a despised and unfashionable idea and I do not know whether, under any circumstances, it will ever come into fashion again".<sup>2</sup>

Till the social and fiscal reforms introduced by the Liberals in the last decade of the 19th century, the increase of State expenditure was parallel to that of the national income as seen in the following table:-

Year	National Income (at market price)	State Expenditure	%
1870-6	1177	72.6	6.1
1904-10	2241	147.3	6.6

Sources: Clark, C: Economics of Progress, 1950, Id.  
p.63 and The Statistical Abstract of U.K.

b. The theoretical development:

It might be true that the increase in State expenditure went parallel with that of national income, but there was not enough reason for taxation to be increased proportionally, simply because income

1. W. Churchill in the Budgetary Discussion in 1902, Ibid p.195.

2. Ibid, pp.99-100



distribution did not stay static. Thus politicians had to find guidance from contemporary theories.

J.S. Mill, who was quoted several times in Parliamentary debates and had given evidence in every Select Committee dealing with taxation during his time, was against any tax that might hinder the accumulation of capital or impede the fostering of the national income. This was the reason for his objection to any tax that might touch saving. He advocated the principle of equality in taxation purposes which was interpreted as "Equality of Sacrifice".<sup>1</sup> If one assumes that everyone gets his reward from work, then, it would be just that taxation exacted from each should be proportional, simply because everyone's income is equal to the pain undergone by the work. But before exacting the tax "a certain minimum of income, sufficient to provide the necessities of life" should be exempted.<sup>2</sup> In no way is the Government justified, according to Mill, in interfering through graduating the tax, as this might affect industry and economy and penalise the people "for having worked harder and saved more than their neighbours".<sup>3</sup> If there was any difference between people, not in merits, but in opportunities, "it would be in the power of good Government to abolish such inequality" by instruction and by legislation, and not by discrimination in the rate of the tax".<sup>4</sup> In other words, State interference should not go further than redressing inequality due to unnatural conditions. This line of reasoning matched the classical concept that individual freedom would

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1. Mill, J.S: Principles of Political Economy, p.805

2. Ibid, p.806

3. Ibid, p.808

4. Ibid, p.511

assure economic equilibrium and produce maximum welfare.

The insistence on the reduction of taxation was thus important as Wicksteed afterwards asserted, because taxation is in itself a kind of interference through which some resources of members of society are transferred "from purposes which they would have selected for themselves to purposes which are selected for them" and which could only be justified if there is proof "that the purposes to which these resources are directed are collectively more important than those from which they are deflected."<sup>1</sup> Thus, any process of relieving the poor at the expense of the rich might probably check the production energies of the community unless the contrary could be fully proved. The safest way is to be neutral in dealing with taxation and to impose an equal percentage rate, after allowing a minimum for necessities, which would tend to reduce all incomes to the same relative position and thus would not interfere with the exchange rates which are the result of economic forces.<sup>2</sup>

In France, "the prevalence of small farms and industrial enterprises" contributed to the domination of individualism which was accepted as "a priori rather than a posteriori"<sup>3</sup> by L. Say and Leroy-Beaulieu. L. Say was very optimistic and a keen believer in the beneficence of "natural law". For a long time he was the autocratic ruler of French finance and his main policy was to ameliorate the incidence of taxation. Like Peel he did his best to remove trade restriction but unlike him

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1. Wicksteed, P.H: The Common Sense of Political Economy, p.660 ✓
  2. Jevens, W.S: Political Economy, p.129
  3. Haney, L.H: History of Economic Thought, p.601

he was very hostile to the imposition of income taxation which he feared would discourage individual effort and thrift. The two French writers tirelessly and vigorously opposed income tax. Say, in his eighties, and early nineties, was reported as having devoted a course of lectures "to show the dangers and iniquities of the system".<sup>1</sup>

This influential French school was in favour of the universality of taxation which could be effected through proportional taxation. This proportionality had been employed since the Revolution to rule out the injustice of the old system and was afterwards turned into a weapon against the rising Radical socialism.<sup>2</sup> The difference in approach to the tax by fiscal reformers on the one hand, and radical opponents of wealth in general on the other, made it difficult for both to bring the tax into being. It seems that the "academic" emphasis, that the income tax should be graduated from the start, frightened the middle-classes whose support was needed to pass such a reform.

In the case of Egypt, the financial pressure and the political difficulties of the 1870's shook the country's social framework. The failure of the Khedive to meet his obligations to the bondholders brought in a foreign dual control, Anglo-French, of the revenue and expenditure. The "open door" policy was adopted and Egypt became a lucrative place for foreign investment. British occupation in the early 'eighties completed the destruction of protectionism and turned

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1. Seligman, op. cit. p.293 ✓

2. Bastable, C.F: Public Finance, p.288.

the country sharply towards liberalism. The Financial Advisers were very much interested in free-trade and interpreted the Commercial Treaties in which the country was involved, as giving equal treatment to foreign and domestic products. Accordingly, if the Government imposed a duty on an imported material, it should levy an equivalent excise duty on similar material produced internally.

The same ideology supplied the background to the resistance of any kind of income taxation which might curtail the profits of traders and reduce the rate of interest of the bondholders, who were largely foreigners. Certain conventions, formally agreed to for a long period of years, provided "Foreigners" with extra-territorial juridical treatment. These conventions were known as "Capitulations" through which the privileged nationals of friendly nations enjoyed liberty of residence, inviolability of domicile, freedom of travel and trade, freedom of religious practice, exemption from local jurisdiction and immunity from any extra taxes and obligations which might be imposed on any subject because of his religious belief.

The study of the Capitulation treaties shows that they were intended to exempt the nationals of the Privileged Powers from certain categories of taxes and obligations, such as the poll-tax on non-Moslems, the obligation of local citizens to feed the army en route, forced labour for emergency needs and so on.<sup>1</sup> But, when the country fell under the

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1. Art.13 of the France-Turkish Treaty of 1604 reads as follows:-

"Que les dits Francais soient exempts de l'impôt de Cassabie autrement nomme l'Ayde de Cuirs...comme aussi de celui des cuirs nomme Reft. Qu'ils ne soient non plus recherches de payer celui des buffles, nomme Badj. Qu'ils soient aussi exempts de payer aucune chose aux Gardes de nos portes et peoges.." See *Recueil des Traites des Traites de Commerce* par le Chev<sup>er</sup> F.D. de Cussy, 1e Partie II, Paris 1835 pp.456 et seq.



strong influence of the West, the Capitulations were fully exploited to the extent of immunizing "the foreigners" from income taxation. Lord Lloyd, at one time a High Commissioner in Egypt, looked on the Capitulations as "the price which a backward Government, incapable of maintaining order in its own territories, has to pay in order to secure the influx of foreign trade and capital".<sup>1</sup>

c. Income Tax at Work:

The theoretical ideas previously mentioned impressed on those responsible for British public finance the need for a policy of equilibrium through budgetary balance. This policy was observed from 1874 to 1899 when deficits in some years were met by surpluses in others. The absence of Income Tax in that period would have meant an over-all deficit of £298.9 m. instead of a surplus of £9.7 m.<sup>2</sup> The existence of the tax made possible a reduction in the national debt in the period of £130 m.<sup>3</sup> With a fluctuating rate between 2d and 8d in the £ income tax "was degenerating into a Chancellor's umbrella to be put up or down according to the signs of the financial skies".<sup>4</sup> But it was still considered as a bad, though useful, tax.

The yearly debates in Parliament and the way in which the Chancellors conducted their financial policies show the manner in which income tax was framed. A scientific study of the real incidence of

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1. Lloyd, Lord G: Egypt Since Cromer, Vol.I, p.21.

2. See figures in Rees, op. cit. ^

3. Figures in Buxton, Vol.II, op. cit. p.363 and Mallet, op. cit. p.495

4. Clapham, J.H: An Economic History of Modern Britain, 1850-1886, p.152



taxation was absent but every endeavour was made to apportion properly the burden of taxation between individuals and among the various sections of the community. At that time of growing State liability, it is interesting to notice the insistence of the Chancellors of the Exchequer on the division of the burden between direct and indirect taxes arising from the crude idea that the former are mainly paid by the rich while the latter are borne mainly by the poor.<sup>1</sup> In addition to that policy, there was the continuous call for equal division of the tax burden between income and property earning groups. Such a constant preoccupation with the problem of equity made it possible for Britain to face the tremendous growth of expenditure without feeling much financial strain or politico-economic disturbance. It seems to have become a traditional rule during the period that equal numerical proportion between direct and indirect taxation should be maintained. If any relief was to be given in one direction, it had to be balanced by similar relief in the other.<sup>2</sup> Ritchie seemed to be very pleased in 1903 when estimates for revenue were 49.1% for "direct" compared with 50.9% for "indirect" taxation.<sup>3</sup> The increase of the rate of income tax from 8d to 1/3 in the £ during the Boer War was accompanied by the imposition of

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1. The outlook on the incidence of taxation was expressed by Buxton, who said "The poor man in every purchase he makes pays for his very poverty", and indirect taxes are "levied more or less at the same rate on the different qualities of the same article". He added, "the inevitable result is that the duty is far more burdensome on the poor, the consumer of these goods. To remedy this inequality if for no other purpose, and to redress the balance between the richer classes and the poor classes, it is essential to levy heavy direct taxation". Buxton, Vol.II, pp.381-2.
  2. This could also be noticed in the allocation of the increase in expenditure between 1875-6 to 1894-5, £12 m. went to the Navy and Army compared with £12.7 m. allocated for education and local authorities. See Mallet, op. cit. p.78.
  3. Ibid, p.217.

duties on sugar, corn and the export of coal. The interrelation between income tax and death duties was also observed and any criticism of the low rate of the former was countered by the argument that it was compensated for by increase in the latter.

When income tax became permanent, it was imperative that it should be cleared of all ambiguity and misconception. Different steps were taken to impose the tax on the true net income as far as possible. Allowances for depreciation were given in Schedule D and even repairs for real estate became deductible.<sup>1</sup> Persons occupying land for purposes of husbandry were given the option to pay on their actual profit in the same manner as in mines. The attitude towards benevolent fund exemption became more accurate. Exemptions for friendly societies were extended and a limited amount of income employed for the benefit of Trade Unions was allowed free of tax. The universality of the tax became more apparent and the differentiation in assessment between England, Scotland and Ireland was terminated. The control over income for foreign sources became more effective. To eliminate the suspicion against tax administration, the system of poundage for civil servants was abolished.<sup>2</sup> Gradually, different measures were adopted to curtail evasion and by the end of the century about two-thirds of the tax was assessed at the source.<sup>3</sup> This made possible the widening of the scope

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1. Allowances for wear and tear increased from about £4 m. in 1893-4 to £11.8 m. in 1902-3

2. Seligman, op. cit. p. 1

3. The spread of joint stock companies facilitated such a course.

of personal allowances and abatements. In 1874, only incomes between £100 and £300 enjoyed abatements, the figure being £80. By 1900 abatements were given on incomes between £160 and £700 and these ranged between £160 and £70.<sup>1</sup>

The rate of income tax between 1878 and 1900 ranged between 5d and 8d in the £. As proportionality was thought to be a symptom of equality, as we have noticed, and differentiation of the rate according to the source was considered impracticable, it became rather difficult to raise the rate without meeting stubborn resistance from the taxpayers. Thus it was realised by Goschen in 1887 that what seemed to be an elastic revenue system turned out no longer to possess that elasticity, and he had to recommend two years later that the State should increase the number of sources of revenue.<sup>2</sup>

The State had pushed simplicity of taxation up to a point beyond which it could not carry out its policy without danger. Goschen's view was not shared by Sir E. Vincent, who thought that "high duties on a small number of articles impede commerce less, cost less to collect, and are probably .... less liable to evasion and fraud".<sup>3</sup> At this stage of development, and in its crude form, income tax could not be expected to play a greater rôle in the fiscal structure. It was important that it should, first of all, rally everyone round it, as the best neutral factor of finance which did not hinder the creation of wealth or interfere

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1. See Buxton, *op. cit.* Vol. II, p. 378 and Mallet, *op. cit.* p. 484

2. Mallet, *op. cit.* pp. 2 and 29.

3. *Ibid.*, p. 158.

with the expansion of trade or hamper the growth of industry. By the end of the century, income tax was well established and was at the point of reformation which would enable it to play a larger part in the increasing socio-economic complexities.

The Boer War brought with it a notable increase in State expenditure and fiscal revolution. In 1907, Asquith made it clear that, recognizing income tax as a permanent part of British fiscal system, something should be done "to remove anomaly and arrive at some scheme, without destroying the essential features or the productive character of the tax."<sup>1</sup> He intended to introduce a system of financial planning to cover several years in order to meet the needs of social reform, and to satisfy meanwhile, the principle of ability. Asquith's policy and that of Harcourt before him, were symptoms of the unqualified adoption of the socio-economic theory, in other words that taxation should be used for the purpose of social and economic regeneration. This was a revolutionary divergence from the neutral outlook which was emphasized by Goschen in 1894 that "the Chancellor of the Exchequer ought to finance for the Exchequer and not for social reform".<sup>2</sup> Following the "new" idealism did not mean that income taxation ceased to be the main factor for financial purposes as it continued to be so in addition to its social function.

In the case of Egypt and France, income taxation was imposed mainly

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1. Hansard, Parliamentary Debates, Vol.172, 1907, p.1202

2. Quoted by Mallet, op. cit. p.92.

from the beginning to finance the growing budgetary expenditure but not to correct the maldistribution of wealth and income. The rôle of the tax in the two countries will be discussed in the next section from the latter point of view. But before leaving this point, one has to note that the criticism of the French taxes in their failure to distribute the public burdens equally, resulted in 1872 in the imposition of a tax on "movable property", that is, on the interest, dividend and other income of corporations. The tax was deducted at the source and bore a proportional rate of 3%. It was not considered as a tax on income, since that would lead to a hostile attitude, but it was considered as an "indirect" impost and not assessed on specific individuals. It is estimated that over 200 projects were submitted to the French Assembly between 1871 and 1909 but all were stubbornly rejected.

In the case of Egypt, the only direct taxes existing up to 1884 were those on land and palm trees. The former was based on the rental value of the land at a rate of 28.64% with a maximum of 164 P.T. (£1. 13. 9) and minimum 18 P.T. (3/9) per acre. The rental estimates on which the tax was based were to be valid for thirty years. The latter was a tax on the palm trees at a rate of 10% of the presumed yearly output. These two taxes supplied about 70% of the State revenue at that time. The "foreigners" did not raise any objection about paying these taxes because the ownership of land by a "foreigner" was considered a privilege in itself. When "foreigners" were allowed to hold land by



an Ottoman Firman in June 10th, 1867, (Safar 7, 1284 Higry) it was stipulated that they would be subject to any tax levied on it.<sup>1</sup>

The Government was prevented from imposing any other kind of direct taxation on the Capitulatory citizens without the consent of their Governments. Article 9 of the Anglo-Egyptian agreement of 1861 states, "No duties of tonnage, harbour, pilotage...or other similar or corresponding duties, of whatever nature, or under whatever denomination, levied in the name or for the profit of government, public functions, private individuals, corporations or establishment of any kind, shall be imposed".<sup>2</sup> When, in 1884, the Egyptian Government imposed a house tax, the "foreigners" refused to pay, and in 1885 an International Conference had to be called by Britain to secure the approval of the Powers concerned for that tax, and in the meantime to discuss the ways and means by which the pressure on Egyptian finance could be alleviated. The Conference agreed on the justice of imposition by the Egyptian Government on their subjects of a house tax, stamp duty and a "licence tax" (a sort of patent).

The house tax was one-twelfth of the rental value after deducting the necessary expenses for maintaining the premises and keeping them intact. The 'foreigners' paid it like other citizens in 1886 and have raised no objection to it since. In a minor incident the Mixed Courts ruled out an attempt by a land company not to pay the excess rate of  $1\frac{1}{2}\%$  which was imposed in Cairo in 1909 to defray the expenses and maintenance

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1. Al-Rifaei, A: Direct Taxes, p.131

2. State Papers, 1860-1, p.18

of the sewage system, which was constructed at that time.<sup>1</sup>

The "licence tax" to the imposition of which the Conference also agreed, was fully implemented only in 1891 after tedious discussion with the representative of the Powers. The law imposed a duty on all persons exercising a trade or profession in Egypt equivalent to 5% of the rental value of the premises used for trade or industry, and on specified trades and professions certain additional dues were charged, sometimes fixed, sometimes calculated according to the capital employed or to the profit realised, and sometimes varied according to the locality.<sup>2</sup> The tax contained certain provisions, inserted by the Powers, in assessment, collection, revision and inspection. Ten months later, France insisted on the abolition of the tax, in order to approve a needed expansion of public expenditure.<sup>3</sup>

Faced with the 'foreigners' stubborn resistance, the Egyptian Government refrained from imposing any kind of income taxation which would be paid only by the Egyptians.

The Land Tax which raised quite a good revenue was reserved as a guarantee for the payment of the international debt service, and the house tax raised but a very little sum, far from enough to pay for the increasing needs of the State. In fact, instead of any expansion in public expenditure, a deflationary policy was pursued in order to comply

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1. Al-Rifaei, op. cit. p.197

2. Patent Tax, Ministry of Finance. Archive, Egypt.

3. When the corvée was abolished, an increase in public expenditure followed. The Government could not easily impose any other tax to meet this new demand and had to rely on the economies resulting from the conversion of the debt which the French could not accept except on condition that the patent tax was to stop.

with the obligations which necessitated keeping any budgetary surplus in the Reserve Fund to guarantee the future payment of the debt charge.

In 1909, revenue was £E 13.7 m. and expenditure £E 10.6 m. Land tax supplied 45% of the revenue receipts, other direct taxes on houses and palm trees supplied 9% and the rest was got from customs duties, octroi, salt and stamp duties.<sup>1</sup> The need Both for the redistribution of the tax burden so as to prevent injustice and for an elastic system was greatly felt during World War I and in the post-war period.

d. The Degree of Effectiveness of Income Tax at this Stage:

The importance of income taxation was significant in this transitory phase in British fiscal history. Before the introduction of the system of progression through the Super tax, and in spite of the broadening of the system of exemption and abatements, every penny rise in the rate of the tax yielded an average of over £2 m, an amount which was increased by another half-a-million during the Boer War and its aftermath, due largely to an increase in prices. The yield of income tax increased from £4 m. in 1875-6 when the rate was the lowest ever reached (2d in the £) being 8.6% of the aggregate from customs and excise duties, until in the first decade of the present century, the yield reached £32.9 million or 51% of the amount collected from customs and excise duties.<sup>2</sup> The increase of income tax burden per head as compared with consumption

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1. Annuaire Statistique, Egypt.

2. See figures in Mallet, op. cit. p.484

duties was as follows:-

The Per Capita Burden of Taxation

Year	Total Population m	Income Tax £m	Per Capita £	Tax on Consumption £m	Per Capita £
1875-1876	32.2	4.1	0:2.6	47.6	1-9.0
1899-1900	41.1	18.8	0-9.6	55.9	1-7.2
Rate of Increase	27.6	358.5	254.0	17.4	-6.3

Source: Statistical Abstract of U.K.

It thus appears that the burden of taxation on income was increasing rapidly, and that on consumption grew in a lesser degree than on population, causing a reduction of the burden per capita. This is not enough to reveal the real burden or the degree of compensation between different groups of taxes or the real burden on population whose productivity was changed during the period together with the proportion of people of working age. The following table gives an attempt at a more concise idea of the burden:-

I Year	1 Population 15-70 age	2 Weight Real Product per Man Hour	3 1 x 2	4 Taxes on Income, Property & Death	5 Taxes on Consump- tion	6 4 ÷ 5	7 6 ÷ 3
1875-							
1876	20.2	.229	46258	12.6	52.6	65.2	141
1899-							
1900	26.5	.301	79765	35.4	64.4	99.8	125
Rate of Increase	31.1	31.4		181.0	22.4	53.1	

Sources: Statistical Abstract and Clark, C: The Condition of Economic Progress, p.63.

From the table we can observe that, weighting per man-hours, we find that the overall burden of taxation 'direct' and 'indirect' decreased from 1876-6 to 1899-1900. However, this is not sufficient indication of the real burden as one has to consider the growth of the national income and its distribution amongst the earning groups and the different amount of tax borne by each group.

On the whole, the most striking feature of the finance of the period was the increasing reliance on income tax as revenue supplier to keep pace with increasing expenditure. Also, it seems that income taxation had not any detrimental effect on the capacity of the people and their desire to accumulate, and the floating of a loan in 1900 is a good example of that. When the list of contributions to that loan closed, it was found that the amount applied for was ten times that needed.<sup>1</sup>

The change of policy on income tax since 1906 with the adoption of the principles of differentiation and progression was an unavoidable consequence after the proportional system, had reached a stage which, if exceeded, might have injured the lower and middle income groups in addition to destroying the elasticity which was a feature of income tax on the whole.

### III. Income Taxation as a Socio-Economic Measure:

#### a. Socio-economic development:

To change the common outlook on taxation from one of neutrality to

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1. Ibid, p.156



one concerned with the implementation of socio-economic ends was not an easy task for any Minister of Finance. The framework of society must be of a suitable formation with its classes well balanced, that the execution of such a policy will follow of necessity and in response to a demand from within. Little wonder then, that the success of taxation in this stage is different in Britain as compared with Egypt and France.

In Britain socio-economic changes had been occurring rapidly since the last quarter of the 19th century. The free-trade idea gave more understanding of business problems and the interrelation of factors of production. The development of joint-stock companies side by side with the Trade Unions made integration between the social classes more necessary and urgent. Profits and wages were increasing but, at the same time, risk-taking became more acute. Cyclical crises became more violent, hitting hard both business and labour and provoking calls on Government, as representative of the people, to alleviate the burden of the depressed sections. Liberal ideals led to social reformers to demand an amelioration of the wretched conditions of the poor and call for more just distribution to wealth and income. Their endeavour was realised in social and economic acts giving pensions to disabled and old persons, insuring labour against ill-health and against unemployment, opening wide the field of competition by granting free education and even supplying food at reasonable prices. All these actions were part of constructive policies in nearly every aspect of the British life. Everyone, man or woman, was given a chance to direct the policy of the community without obstruction from any particular section. It is thus

that taxation became a flexible tool in the hands of the State to attain a specific social or economic end.

In Egypt, conditions were somewhat different. There was a hard fight against the Capitulatory régime which went on side by side with the National political question. The latter was partly settled in 1936 and was followed by the termination of the former in 1937. This success gave an impetus to social clamours to better the conditions of the people and called upon the economic architects to seek a more constructive policy. Society was largely disintegrated, with landlords and business magnates dominating the political scene and with the lower strata in an appalling condition, depressed and disorganised. Wealth was badly distributed and the income gap between classes was very wide, a condition which explained the political outbursts and the social unrest. It was a state of two distinct worlds, with a vacuum in between, and it was not easy for either to move down and up in order to meet and to work for the benefit of the two together, as a whole. When Capitulation came to an end, the rich class did not of course, reveal their intentions or things would have been different. They verbally showed their approval of the principle of socio-economic equilibrium in theory, but when it came to constructive policy the taxation measures taken looked inferior in standard and ineffective. In spite of that, it is necessary to analyse the taxation measures which were claimed to be for a socio-economic end, to find out whether they worked properly towards such an end.

The state of France lies somewhere between that of Britain and that of Egypt. Its industry was less progressive than that of Britain. Its national income and the productivity per man was also less than in Britain. According to Colin Clark's calculations national income per head of working population in international units was 641 in France compared with 1,093 in Britain in 1934.<sup>1</sup> Product per man-hour was 362, compared with 588 respectively in 1938,<sup>2</sup> and even in manufacturing industry France lagged behind by about 8.6%.<sup>3</sup> The country is mainly divided into two groups highly sensitive to their interest, i.e., agriculturalists with medium-sized holdings and industrial labourers. In making his policy, the Minister of Finance had to be impartial between the two sections. The disharmony is clear from the repeated incidents when the Cabinet had to resign over simple fiscal measures, such as subsidising religious schools or fixing a bonus for increasing prices or imposing an extra duty. Such a stage has long been passed by Britain and since the People's Budget the Chancellor of the Exchequer has become the dominating figure in the implementation of the Government policy in the fiscal sphere.

b. Theoretical development:

The change in the composition of modern society and in outlook on the state gave a fillip to socio-economic and socio-political theories of taxation. In his theory, Wagner stated that "the State should so

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1. Clark, C: The Conditions of Economic Progress, p.148

2. Ibid, 1951 Ed. pp. 63 and 80

3. Ibid, pp.369 and 271

order its expenditure, tax system and loans as to remove certain economic and social evils", and that "taxation, in addition to serving the purely financial purpose of providing sufficient revenue, should be employed for the purpose of bringing about a different distribution of wealth from that which would result from the working of free competition upon the basis of the present social order".<sup>1</sup> While British and French writers were cautious in adopting such view, the application of their theories to the existing conditions resulted in the same end. The graduation of taxation is in accord with the Marginalist analysis and the theories of sacrifice. Edgeworth's 'least aggregate sacrifice' may even result in increasing the rate of taxation to a confiscatory limit. Some writers took a moderate standpoint and approved graduation according to the size of income and differentiation according to the nature of the source and the duration of its yield, but to a limit that would not impair the degree of productiveness of the taxpayers.<sup>2</sup> The Marshallians discarded the 'benefit theory' of taxation and stressed the non-compensatory nature of federal taxation. Their interest lay in optimum production and welfare. Through a certain determinate scheme of imposing a tax on industry operating under conditions of decreasing return or increasing costs, and granting bounties to those showing increasing return an optimum production would most probably occur.<sup>3</sup> Such a scheme, it was asserted would lead to the equalisation

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1. Comstock, A: quoting Wagner: Taxation in the Modern State, pp.38-9

2. Nicholson, J.S: Principles of Political Economy, Vol.III, p.274

3. Pigou, A.C: Studies in Public Finance, p.99 ✓

of the marginal private and social net product and so establishes real harmony in the socio-economic framework. To carry out its obligation to execute the policy of the maximum aggregate welfare, the State should direct taxation to yield the maximum revenue and have minimum effect on consumers' surplus.<sup>1</sup> This would lead to favouring income taxation rather than consumption taxes, because the latter by altering relative prices becomes partial and would result in the taxpayer carrying an excess burden by reducing him to a lower indifference curve without due gain to the treasury.<sup>2</sup>

World War I and its after-effects of inflation and dislocation of international trade and the great depression of the inter-war period, which curtailed profits and deprived millions of employment were enough justification for the Keynesians to advocate the employment of taxation to deal with the rising problems. Reducing inequality in the distribution of wealth and income was even looked at as a factor which kept high the propensity to consume and thus remedy unemployment and help the growth of the aggregate of wealth. Progressive taxation was then approved to play such a rôle but to a stage not great enough to depress business confidence or inhibit spontaneous optimism.

The significant factor in these different theories is their firm adherence to the system of progressive income taxation as part of fiscal structure to achieve socio-economic ends.

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1. Ibid, p.74

2. Joseph, M.F.W: The Review of Economic Studies, Vol.VI, pp.226 et seq.



The same thesis was reflected in the Dilke and Colwyn Committees of 1906 and 1927 in Britain, in Caillaux's Income Tax Bill of 1907 in France, and in the Report of Taxation Committee of 1938 in Egypt. The report of the Dilke Committee favoured the system of graduation and differentiation but for practical reasons they advised caution. Because full graduation would mean the abandonment of the principle of stoppage at the source and its substitution by the impractical system of personal assessment, they desired the imposition of a super-tax after a certain limit. The lower incomes would receive abatements similar to those which existed at that time.<sup>1</sup> The principle of differentiation was desired by the Committee and it wished that "earned" and "unearned" incomes should be clearly defined; but that did not require that incomes irrespective of their size should be so treated. It was of the opinion that such differentiation should not be applicable over a certain amount.<sup>2</sup> The Colwyn Committee in its turn argued that progressive taxation of income was justified, in the main, by the general rule of decreasing marginal utility of income as the income grows. In spite of the difficulty of measuring the degree of depreciation in the marginal utility in each individual case, however, "the State is bound to take a more or less objective standard".<sup>3</sup> To complete their view by dealing with the other part of the formula, they examined "Social expenditure which brings claims of production and distribution into sharp contrasts",<sup>4</sup> and came to the conclusion that "social expenditure

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1. Seligman, op. cit. pp.197-8

2. Ibid, p.200

3. Colwyn Committee Report, pp.122-3

4. Ibid, p.105

is not only highly necessary as a matter of humanity and social justice, but is also, up to a point, essential to the promotion of industrial efficiency".<sup>1</sup>

In France, the Caillaux project was composed of two taxes; one on the schedular incomes and the other on income in general. The former embodied differentiation according to the source of income and the latter meant graduation according to the size of income. This was thought to be in accord with the "faculty" principle.<sup>2</sup> To justify his project, Caillaux declared in 1908 that it was necessary to supply an adequate sum to cope with increasing expenditure and especially that for social reform. Moreover, it would help to enhance economic and industrial development by alleviating their burden.<sup>3</sup> The same argument could be found in the Report of the Taxation Committee in Egypt which was influenced by the French taxation system. An additional factor was included to justify the imposition of income taxation and that was the necessity of distributing the tax burden equally between all citizens without reference to their nationality.

c. The development of income taxation practice to fulfil socio-economic ends:

In 1907, Asquith introduced the long awaited Liberal social reform. He considered the case of the child, "the raw material upon the fashioning of which depends whether it shall add to the common stock of wealth... or whether it shall be cast aside as a waste product"; and considered

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1. Ibid, p.105

2. Seligman, op. cit. pp.310-2

3. Ibid, p.319

also aid to all those who were "nearer the other end of the journey of life..."<sup>1</sup> To pay for this bill he did not specify a certain section but made it the liability of "the whole nation - the working and consuming classes as well as the wealthier class of direct-tax payers".<sup>2</sup> But when he adjusted his formula, he laid stress on income tax and followed the recommendations of the Dilke Committee in differentiating between the rates of "earned" and "unearned" incomes. This step was followed up in 1909 when Lloyd George introduced a bill which dealt not only with old-age pensions but also with the relief of unemployment and the development of the deserted and impoverished parts of Britain.<sup>3</sup> To justify the imposition of a super-tax on incomes over £5,000, he stated that "the time, however, has gone by when a simple addition of pence to the poundage of the tax....can be regarded as a satisfactory solution of a financial difficulty".<sup>4</sup> This Bill started the well-known controversy which was ended by the termination of the veto power of the Lords over finance Bills (Parliament Act, 1911). By 1913, the British income tax structure embodied graduation by exemption and abatements of all incomes not exceeding £700, graduation by rate in the case of "earned" incomes only up to £3,000 and graduation by super-tax on incomes above £5,000. The socio-economic taxation ideal was followed after that time and was not interfered with even during hostilities.

After 1909, expenditure on welfare increased swiftly and greatly.

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1. Hansard, The Parliamentary Debates, Vol.172, 1907, pp.1198-9

2. Ibid, p.1192

3. Hansard, Vol.IV, 1909, pp.474 et seq.

4. Ibid, p.506

In the inter-war period, expenditure on welfare exceeded 25% of total State expenditure and the aggregate figure was in 1938 more than eight times greater than the figure in 1911, and by 1950 it was about five times more than the pre-war level. Welfare expenditure reached £1,306 m in 1950, an amount equal to 40% of the whole State expenditure. Unemployment insurance which included the Exchequer transitional benefit payments and unemployment allowances increased from £11.8 million in 1929 to £81.9 million in 1934, being 6% and 30% respectively of the total welfare expenditure.<sup>1</sup> Expenditure for economic ends, in its turn, has been quite remarkable since World War I; subsidies were given to certain domestic industries to assure their continuity or to offset their deficits as in the case of sugar and coal. An important achievement in this respect has been the Labour Government's policy in the post-war period of nationalisation, economic control, bulk buying and the construction of certain economic schemes of a risky type. Without discussing the wisdom of such measures we can say that their main aim was the planning of the economic structure of Britain in a way which would ensure full employment and readjust the distribution of national income in a manner favourable to the working class section of the community.

In order that the Government could fulfil this socio-economic pledge, income taxation had to play a prominent part. The graduation system had been broadened after World War I and its success encouraged the Chancellor of the Exchequer to raise the rate on the upper reaches

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1. Statistical Abstract of U.K.



of income to 9½% in 1950. Private enterprises are burdened by a peculiar levy, that is the "Profits Tax" which replaced the N.D.C. in 1946, and seems to have become a permanent feature of the British fiscal structure. While the high income groups were highly squeezed, the lower strata came to have a comparatively better position, enjoying family allowances and being assured of a minimum standard of living. Even during the Depression and the post-war difficulties the socio-economic principle of taxation was observed. The following table gives the effective rate of the tax paid by various income earning groups.

Amount of Income and Effective Rate of Tax Payable.  
(Single Person)

Income £	Income all earned Year			Income all invested Year		
	1929	1939	1950	1929	1939	1950
150	-	1	1	1	3	3
500	7	11	17	10	17	26
1,000	12	17	27	15	22	27
5,000	23	32	49	24	33	53
10,000	30	42	64	31	43	74
100,000	47	67	94	47	67	94

Sources: Inland Revenue Reports.

In France, the main concern of the Minister of Finance after World War I was to secure the equilibrium of the budget. The socio-economic call for the extension of expenditure on welfare and public works was of secondary importance. This was a sound principle, since the depreciation of the currency, if not checked would have resulted in the reduction of the real incomes of that section of the community which was more in need of welfare. To achieve such an end, an increase in



State revenue and economies in expenditure were necessary. In 1924, following a sharp fall of the franc<sup>1</sup> an over all increase of 20% on the taxes was introduced, and was followed by a capital levy of 10% in 1925. But all these actions, drastic though they were, were ineffective and there was no escape from the dilemma except by reducing the exchange rate of the franc in terms of gold which was due in 1926. Then balancing the budget became a possibility, until the great depression of the 30's.<sup>2</sup> An expansion of welfare expenditure took place after the social legislation of 1926. Welfare expenditure, which includes allowances for education, social services and pensions increased by far more than the proportional increase in the State aggregate expenditure. Between 1927 and 1933, the increase was 66% compared with less than 13% increase in the aggregate.<sup>3</sup> Housing subsidies were extended, assistance to large families was given and social insurance benefits have been increased. The continuous budgetary deficit after 1933, did not give the people much chance to press forward any significant increase in the proportion spent on welfare, or it might be their desire to limit State intervention, that kept expenditure on this item within reasonable bounds. Welfare expenditure reached 18% of the aggregate State expenditure in 1938, compared with less than 20% in 1946.<sup>4</sup>

The financial difficulties and the social pressure contributed to structural changes in other parts of the taxation system. To facilitate the working of its mechanism, France went in December, 1948,

1. The exchange price of the franc depreciated from 75.7 frs. for the £ in 1923 to 120 frs. in March, 1924.
2. Dalton, H: and Others. Unbalanced Budgets, p.277.
3. See figures, Ibid, pp.283 and 296.
4. Brochier, op. cit. p.80 and Laufenburger, Précis, p.164

half way towards the British system. The schedular taxes were unified under what is now called "l'impôt sur le revenu des personnes physiques", being a tax on individuals and bearing a proportional rate of 18% to be accompanied by a super-tax on a progressive scale, and another levy on profits of corporations known as "l'impôt sur les bénéfices et revenus des sociétés et autres personnes morales" bearing a standard rate of 34%.<sup>1</sup>

The attempt made to achieve socio-economic ends is reflected in the exemption limits, the abatements and the degree of progression. The average rate of the tax on general income in France reached 12.3% in 1938 and was only 9.1% in 1946,<sup>2</sup> compared with 7.1% and 16.9% respectively in Britain. Differentiation between the rates of the tax according to the source was retained after the introduction of the system of the schedular taxes. Even in the 1948 Reform, a certain formula was found to assure the continuance of this principle. The effective rate of the tax on income from "movable property" which could be termed as "unearned" was relatively higher than if the income was derived from work, as is seen in the following:

Rates on Income derived from:

	<u>Movable Property</u>	<u>Property</u>	<u>Com. and Ind.</u>	<u>Agricul.</u>	<u>Work.</u>
1938	29.7	7.1	4.3	0.1	1.8
1946	28.8	-	3.6	0.6	3.5

Source: Brochier, op. cit. p.47

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1. See Memento Fiscal, Paris, 1951
  2. Brochier, op. cit. p.42

According to the "new" reform in which a standard proportional rate was levied, "earned income" which is realised from wages, pensions, professional and artisan work, is assessed at half the tax rate if the taxable income does not exceed 200,000 francs (£204).<sup>1</sup> The progression starts on incomes over 150,000 francs and ranges between 10% and 60%.<sup>2</sup>

The margin of exemption and family allowances have fluctuated mostly in accordance with the economic changes. In 1938, earnings of 10,000 francs were exempted from the general income tax and by 1946, an exemption figure of 40,000 francs was reached while progressive rates ranged between 1% and 40% in the former case compared with 12% and 65% in the latter. For family allowances (quotient familial) taxable income was divided in parts varying according to the situation of the family and every part was taxed separately. In addition to that, there were other exemptions attached to the schedular income taxes. By later changes, from 15% to 100% of the income could be deducted as family allowance on condition that the deduction would not exceed 5,000 francs for the first child and 15,000 francs for each other child.

The effective rate on different income groups in relation to

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1. In the case of wages, from 3% to 5% are first deducted from the money income to reach the taxable income; this amount is considered as necessary for insurance purposes, cf. Memento Fiscal.
  2. According to 1950 budgetary Act, Ibid, p.62

schedular and general income taxes in 1946 was as follows:

Range of Income	Income derived from:				
	Salaries etc.	Com. and Ind.	Profession	Agric.	General Income
1,000 francs					
50-100	3.7	13.7	16.6	14.8	5.3
200-500	9.0	22.3	19.7	18.8	15.8 x
500-1000	-	24.0	23.5	12.9	28.2
over 1000	-	-	-	-	36.5
x On income between 300,000 and 500,000 francs.					

Source: Brochier, op. cit. pp.41 and 45

From the above one can observe that the highest rate paid from income was 36.5%, a rate which was paid on incomes over £2,000, that is equivalent to less than one million francs.

In Egypt, social legislation has gathered increasing momentum since the 1919 Revolution. There has been great pressure to widen the scope of education, improve the people's health and alleviate their sufferings. Less than a million pounds was spent in 1913 on welfare services out of a budget of £16 m. or about 6½% in 1937, the welfare expenditure was £6 m. out of a total outlay of £42 m. or over 14%. The rapid increase in this sphere was clear after the last war when £26 m. out of £113 m. were destined for welfare or 23%; the welfare expenditure went sharply up to £51 m. in 1949-50 being 31% of the whole.

This great increase was met before the last war from the "old" property taxes and a levy on the salaries of State personnel<sup>1</sup> which was first imposed in 1931. The land tax remained unchanged in its assessment for 35 years and only in 1935 were the new valuations made and

1. The exact figure of welfare expenditure in 1937 was £6.2 m. and the yield of the whole direct taxes was £6.4 m.



the rates fixed with the same maximum charge per acre as before. As a matter of fact, the average rate was reduced so that the yield of the tax would not become greater than it was before. No change occurred in the house tax, but an excess levy over it helped to increase its yield. That levy is a quid pro quo tax, known as the Ghaffir<sup>1</sup> and was originally imposed to meet the expenses of police protection of property. It took fiscal form in 1936 when it was fixed at 20% of the house tax and collected from all proprietors liable for that tax.

Before the termination of the Capitulations, the Government made tremendous efforts to impose a "patent tax" on the 'foreigners' without success and a project proposed in 1929 was rejected. The force of the depression and the dire need for revenue compelled the Government to levy a tax on the earnings of its own personnel. It was put into operation in September, 1931, at a rate of 2% only, and supplied an amount just short of one million pounds. In 1936, the lower ranks were exempted and the yield of the tax sank to £E.300,000 in 1939 when it was abolished, giving way to the Schedular taxes, which were imposed following the Montreux Conference.

The Schedular Income Taxes were much advertised and claimed by the politicians as a big step towards equitable distribution of the public burdens. Consideration of the post-war welfare expenditure shows the inadequacy of this view. Only part of these expenses were met by income taxation. In other words, the poor people who might

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1. Ghaffir in Arabic means the watchman



benefit from such expenditure had to pay a high price for it with a great loss of consumers' surplus, a different state of affairs to that in Britain, as can be seen in the following table:

	<u>1946-47</u>		<u>1949-50</u>	
		in £ Mn.		
	<u>Income and Property Taxes</u>	<u>Welfare Expenditure</u>	<u>Income Taxes</u>	<u>Welfare Expenditure</u>
Britain	1,592	876	1,847	1,306
Egypt	19	26	23	51

Sources: Statistical Abstract of the U.K. and Pocket Book of Statistics, Egypt.

Moreover, the rates of the schedular income taxes were almost proportional<sup>1</sup> and very minor exemptions were given which could not be compared with the privileges conferred on certain section of taxpayers as professionals, beneficiaries from State lands and earners of agricultural profits. Even the E.P.T. which balanced the burden between taxpayers and yielded about ££76 m. was abolished in 1950 in favour of a general tax on income imposed in 1949. The latter tax is of a graduated nature, starting at a rate of 5% on income between ££1001 and ££1500 and reaching 50% only on incomes over ££100,000. It contains many loopholes and the expectation of its yield is discouraging.<sup>2</sup>

d. The effectiveness of income taxation as a socio-economic measure:

The effectiveness of income taxation as a socio-economic role depends on the influence it exerts towards the redistribution of income

1. The tax on wages and salaries is the only progressive one, with rates ranging between 2% and 7%
2. It is expected that the {new' general income tax would yield one million pounds only; an amount less than the yield of the house tax. The sliding scale was made sharper by the end of 1951 with the progression ranging between 8% and 70%

and wealth. Progressive taxation tends to redistribute income in favour of the poorer classes and if progression is very marked, the high income earners might cease to accept work entailing great liability or to invest in risky operations. Taxing reserves and operating excess profits duties, would limit accumulation of capital and effect a redistribution of wealth. On the whole, everything being equal, national income would most probably be reallocated in favour of wage and salary earners and against others.

In Britain, the socio-economic part which income taxation plays is very clear. Total income before taxation was £4,322 m. in 1938, and at that year's rates the income after tax was £4,015 m. and in 1949-50 rates it was calculated at £3,859 m. which means that the tax absorption was 7.1% and 10.7% respectively. The important thing that one has to consider is that most of the excess burden was borne by the high income groups. The section whose incomes were £10,000 and over paid 57.7% of their income in 1938 at that year's rates and would have to pay 79.8% at 1949-50 rates.<sup>1</sup> Even if the rates were stationary, the rise of prices which brings with it a relative increase in money incomes would shift the taxpayers to a higher scale of tax.

In France, the available figures show a relative reduction in the average rate of income taxation from 12.3% in 1938 to 9.1% in 1946.<sup>2</sup> Most of the increase was borne in 1946 by the low and middle income

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1. National Income and Expenditure of the U.K. 1946-50

2. Brochier, op. cit. pp.44-5

groups; 79.5 Mld. francs were exacted from different classes of income out of which 57% was paid by the section whose income did not exceed 300,000 francs or £625. In Britain, in the same year, those with incomes of up to £1,000 paid only 28% of the tax. There are no figures showing the state of tax payment in Egypt but it may be fairly said that the burden is progressive in indirect relation to the degree of poverty and the increase of family responsibilities.

The taxable part of the gross amount of profits and property assessed for income tax in Britain decreased gradually from 1875 till the outbreak of the last war. The largest contribution in the various schedules of income taxation now comes from Schedule E and this shows a logical tendency as the wage portion of the national income rises. Income from Schedule B, on the other hand, is gradually added to Schedule D, thus making the assessment according to the real return of the tenants. The following table gives a brief summary of this point.

Distribution of Gross Amount of Profits  
and Property Assessed for Income Tax.  
in £ M.

Year	A	B	C	D	E	Total	Taxable Part	%
1875	162	67	43	267	33	572	498	87
1913	176	5	48	584	138	951	792	83
1925	363	49	132	1324	1083	1971	1349	68
1938	573	47	171	1415	1784	3990	1437	36
1950	396	1	214	2580	6175	9366	4271	46

Source: Statistical Abstract and Reports of Inland Revenue.

The similarity between Egyptian and French income taxation makes possible a comparison of the yields according to the source of income.

The proportion of property taxation and of "direct" taxation was 70% in 1939-40 in Egypt when the schedular income taxes were in full operation for the first time. This balance was changed by 1946-7 and income taxation took 6% with the main burden being levelled on commercial and industrial enterprises. In France, which is highly industrialised and much more efficient than Egypt, commercial and industrial concerns paid only 25% of the "direct" taxes in 1946 compared with 21% before the war. An insignificant amount was collected in Egypt from professionals, the most privileged section in the community. The following table gives the distribution of "direct" tax yield according to the schedules of income:-

<u>Source of Income</u>	<u>EGYPT</u>				<u>FRANCE</u>			
	1939-40		1946-7		1938		1946	
	£m.	%	£m.	%	Mld. frs.	%	Mld. frs.	%
Movable Property			2.3	12	5.8	39	10.1	13
Com. and Ind.			x 8.9	47	3.1	21	21.5	25
Salaries etc.	2.7	30	1.9	10	1.2	8	29.5	37
Profession			0.03	0	0.3	2	2.0	3
Property and Agric.	6.3		5.8	31	1.4	10	5.3	7
General	-	-	-	-	3.0	20	12.0	15
Total	8.9	100	18.9	100	14.8	100	80.4	100

x Being £3.6 m. the normal tax and £5.3 m. E.P.T.

Sources: The Budgets of the Egyptian Government.  
Brochier, op. cit. p.36.

The rôle of income taxation as a socio-economic measure cannot be fulfilled unless the yield of the tax exceeds the welfare expenditure by the amount of the administrative expense and unless all the privileges are removed and progression is accurately operated. These reservations

have been wholly observed in Britain, giving a situation which has proved the success of its income taxation as a socio-economic measure. Per contra, the Egyptian tax has failed to play that rôle, although it has succeeded in supplying the State with an ample sum to pay for increasing expenditure. As for France, the continuous budgetary deficits since 1933, show the difficult task which income taxation must perform there. Even if welfare expenditure were increased and income tax progressed, a problem arises due to the counter-effect of budgetary deficit which seems likely to necessitate devaluation from time to time.



## CHAPTER III

### THE SCOPE OF INCIDENCE OF THE INCOME TAX SYSTEM

Definition of income for taxation becomes especially essential after the adoption of the progressive scheme and the excessive burdens in the tax return. By means of the definition we can recognize the

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taxpayer and trace the incidence of the tax on him, or on the other hand, its effect upon capital formation and the incentive to work. A proper definition is also of special importance in finding out to what extent the universality principle in taxation is functioning and to assure that taxation does not extend to sources not earmarked by the legislature. Moreover, the State's need of revenue is constant and it has to base its estimates upon accurate figures of the regular flow of revenue from the subjects or citizens. With regard to the economy, some clear definition might help in analysing the effect of income taxation on the national economy. Inability to arrive at a concrete definition might have serious repercussions in the social and economic structure of society.

#### a. Differences in theoretical definitions:

Income is still a controversial subject; there is the periodicity concept of Allen and Lister, the consumption concept of Millard, Hermann and Schöller and the source concept of Struts and Pustian. According to these concepts income may denote a flow of wealth during a definite period of time or it may mean the aggregate money receipts minus that part appropriated for investment, or it may be the total

### CHAPTER III

#### THE NOTION OF INCOME IN THE INCOME TAX FORMULA.

Definition of income for taxation becomes especially essential after the adoption of the progressive scheme and the excessive increase in the tax rates. By means of the definition we can recognise the taxpayer and trace the incidence of the tax on him, or on the other hand, its effect upon capital formation and the incentive to work. A proper definition is also of special importance in finding out to what extent the universality principle in taxation is functioning and to assure that taxation does not extend to sources not earmarked by the legislature. Moreover, the State's need of revenue is continuous and it has to base its estimates upon accurate figures of the regular flow of revenue from its subjects or citizens. With regard to the community, some clear definition might help in analysing the effect of income taxation on the national economy. Inability to arrive at a concrete definition might have serious repercussions in the social and economic structure of society.

#### a. Differences in theoretical definitions:

Income is still a controversial subject; there is the periodicity concept of Allix and Lecerclé, the consumption concept of Malthus, Hermann and Schmoller and the source concept of Strutz and Fuisting. According to these concepts income may denote a flow of wealth during a definite period of time or it may mean the aggregate money receipts minus that part appropriated for investment, or it may be the total

services received from all sources including the individual's own activity. The first definition excludes casual earnings and increment of value from the scope of income; the second leads to the exemption of savings; and the third is of a sweeping nature and confuses income with capital and embodies some elements which are almost impossible to determine in terms of money.

The confusion in the definition arises from confusion between the words 'income' and 'revenue' which have different meanings in various languages. According to the Oxford English Dictionary, the noun 'revenue' means the return, the yield or the profit on any land, property or other important source of income. The word 'income' means that which comes in as the periodical produce of one's work, business, land, or investment (commonly expressed in terms of money); or the annual or periodical receipts accruing to a person or corporation. Sometimes the words revenue and income are taken to mean the same. The Encyclopaedia Britannica has defined income as the "satisfactions which are capable of being parted with, or are usually parted with for money." It makes periodicity an essential aspect of the word. Other definitions of Haig, Seligman and Fisher, which give a different outlook, were also given. In Arabic the word 'revenue' has a wider meaning compared with the word 'income', with the former including the net accretion to the individual in a period of time, while the latter includes only that which comes in as a result of the individual's activity or the acquisition of any right whether property or not. The French have only one word 'revenu'

which means, according to La Grande Encyclopédie, the amount of wealth which is employed for the satisfaction of needs without diminishing the source. The word 'revenu' is interpreted sometimes to embody the return or the periodicity of the receipt (retour d'une recette ou une recette qui revient).<sup>1</sup>

Several definitions of income are offered by economic and fiscal writers from time to time. But they should not be interpreted as suggesting that taxable income rests on any well framed academic formula. The differences in the definitions applied "are due to different conceptions of the nature of income, constitutional limitations on the legislature, political or economic considerations, and conventions with other countries".<sup>2</sup> That does not mean that academic concepts have had no influence in determining any practical income formula. They help to clarify the confusion in legislation about income and make it easier to distinguish between the product and its source in such a way as not to hamper the working of the economic process.

The definition of income is largely affected by its relation to capital. In a simple manner Adam Smith thought that income was a function of capital during a period of time and thus income was the product of capital.<sup>3</sup> Such a definition is based on the existence of a physical stock of instruments from which flows a stream of services through time. It does not include any benefit which may arise from the acquisition of certain rights such as goodwill. This definition makes it clear that

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1. La somme de biens que dans un temps déterminé un sujet peut employer à la satisfaction de ses besoins sans diminuer son fonds.

See also Al Rifaei, A: Direct Taxation, p.42.

2. Spaulding, H.B: The Income Tax in Great Britain and the United States, p.117.

3. Fisher, G: The Nature of Income and Capital, p.54.

income is the result of capital but it might equally well be stated that capital value is a result of income.

In some cases only capital has an intrinsic value which is equal to the satisfaction which one enjoys in using it for consumption. The adherents of the capitalisation norm consider capital value of any source as the aggregate sum of the present worth of all anticipated successive values.<sup>1</sup> Their objection to the existence of a separate determinateness of the value of the source and its product is a denial of the fact that the market of the two elements is influenced by more than one factor.

One might ignore the physical relation between source and product and go a step beyond that as J.S. Mill did and look at the problem from the point of view of individual. According to Mill, the distinction between capital and non-capital depends on the intention of the capitalist or individual who directs his wealth either to consumption or to investment.<sup>2</sup> But this outlook cannot help us because, for taxation purposes, the State cannot be left to the mercy of the individual's decisions and tax only what he intends to dispose of for consumption. It is necessary for taxation purposes that the definition should be universal as far as possible and not left as a matter of individual decision.

Seligman defined income as contrasted with capital as denoting "that amount of wealth which flows in during a definite period and which

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1. Seligman, R.A.E: Studies in Public Finance, p.103.

2. Fisher, op. cit. p.54



is at the disposal of the owner for purposes of consumption".<sup>1</sup> In another instance he considered the characteristics of income as a realised inflow of satisfaction capable of being transmuted into money terms. It was something distinct and separate or could be separated from the source.<sup>2</sup> This definition is similar to that of Pigou, that income is "the net inflow of goods and services, necessities and conveniences of life that accrue" during a period of time.<sup>3</sup> Pigou emphasised that "only that part of real income which has a money counterpart can be brought into account" for taxation purposes.<sup>4</sup> Such a definition assumes the existence of a source or a fund from which a flow is derived. Accordingly income is that part which can be extracted or isolated without impairing the effective reproduction of the source. This definition looks realistic in the case of a fruit produced by the tree or the calf by the cow. But it fails to explain the case of extractions from natural deposits where exhaustion is a matter of time and no account of depreciation could be substituted materially for what is already taken. Even in the former case the production would have a certain physical or biological effect on the source and sometimes the depreciation could not succeed in restoring the source to its former position. The former definition of income would also fail to give a concrete indication as to how we should deal with transactions in the factors of production.

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1. Seligman, R.A.E: Income Tax p.19
  2. Seligman, Studies in Public Finance, pp.99-101
  3. Pigou, A.C: Income, p.2
  4. Pigou, A Study in Public Finance. L

Plehn made an attempt to define income as the "recurrent, consumable receipts".<sup>1</sup> In his theory, Plehn, included revenue from labour, capital, land, as well as annuities on pensions and savings out of income. He excluded gifts and bequests as nonrecurrent items in the form of capital gain from capital transaction. In reality, there is no clear cut method according to which one can say that dividend is a recurrent receipt and capital transactions are not, as the contrary might well be true. Moreover, to consider income as consumable can mean almost nothing, unless it means "consumable without impairment of capital".<sup>2</sup>

Almost identical to the Plehn definition is that held by Allix and Lecercle in France, which is known as the theory of utilisation (these d'exploitation). The theory defined income as the periodical product, or as susceptible to periodicity of a durable source which consisted of personal activity, work, or other material wealth.<sup>3</sup> This definition interprets income by stressing its characteristics. It looks logical and consistent but upon examination seems inoperable. If such a definition were agreed to, it would curtail the scope of income for taxation and restrict it to the returns from durable factors of production. The definition would also reduce the concept to the static state where the returns could be freed from the admixture of capital ingredients. The application of regularity would exclude occasional earnings and

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1. Plehn, C: American Economic Review, Vol.14, 1924, pp.1-12

2. Simons, H.C: Personal Income Taxation, p.75

3. "In their book "Impôt sur le Revenu" Tom. Ie p.351 Allix and Lecercle stated "Le revenu, avons-nous dit est le produit periodique ou susceptible de periodicité d'un source durable, qui peut consister dans l'activité personnelle, ou travail, ou dans certains biens matériels ou incorporels".

windfall profits from the taxable income while including the life-annuities and pensions which could be considered as invested capital. This theory cannot give a precise answer to such borderline questions as whether the distribution of stock dividend should be included in the taxable income or not. Seligman made it clear that "neither the permanence of the source nor the regularity of the receipts any longer forms a necessary part of the concept of taxable income".<sup>1</sup>

Schanz, Haig and Simons gave a radical definition of income for tax purposes. To them income is the money value of the net accretion to one's economic power between two periods of time. This definition is similar to the Mercantilist notion that the difference in the balance sheet at the opening and the close of the year determines the income of the individual or the corporation in that period. The theory does not refer to the origin of the revenue or the element of duration.<sup>2</sup> It includes any creation of value through human labour, or capital utilisation as well as all the increment of value of any factor. This theory is known in France as the 'théorie de la plus-value' and sometimes the 'thèse du bilan'.<sup>3</sup> Simons made it clear that personal income is an acquisitive concept, it connotes, broadly, he declared the exercise of control over the use of society's scarce resources and can be calculated through the increase in "value of a person's store of property rights"

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1. Encyclopaedia of Social Sciences, Art. Income Tax

2. According to Laufenburger "tout enrichissement ou tout accroissement de valeur est un revenu, quelles qu'en soient l'origine et la durée" See. Traité D'economie et de Legislation Financières, p.37.

3. Laufenburger, H: Finances Comparées, p.184

if his consumption is nil, or "the value rights which he might have exercised in consumption" while the value of his store of rights is unaltered.<sup>1</sup> This theory widens the scope of taxation and puts an end to the dispute and confusion as to what is income and what is not. It might be an appropriate arithmetical answer<sup>2</sup> to the difficulty of determining the taxable income, but it is dangerous in application during a time of violent change in prices. According to this theory, gratuitous receipts in the shape of gifts and bequests are to be included as taxable income because their exclusion "would be to introduce additional arbitrary distinctions".<sup>3</sup> All additions to capital even if they are inchoate gains are to be taxable. This is justified because of the acceptance of the idea of the impairment of capital as giving a reason for a proper deduction from the taxable amount. To widen the scope of taxable income to this extent, would threaten the existence of capital and create a false impression of the meaning of income in the minds of the people.<sup>4</sup>

Whatever our theoretical definition of income, the applied definition is more arbitrary. It is formulated according to administrative factors, or to adjust specific public policy, or as a reaction to the pressure of the different interested groups in society. Income according to Simons "would be readily and accurately measurable

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1. Simons, op. cit. p.49

2. Ibid, p.51

3. Ibid, p.56

4. It was alleged that considering an augmentation of wealth and income the increase in the value of stocks in the boom before the crisis in 1929 inflamed speculation and hastened the collapse.



only in a world where goods and services fell nearly into a small number of homogeneous classes"<sup>1</sup> and where an accurate market for capital valuation was existing. It is sufficient in practice that income taxation is not confined to a specific theory, but merely sets up rules as to what is the gross income, and what is to be deducted to reach the net taxable income.

b. Income subject to taxation:

Income tax laws do not attempt to define income for tax purposes. They simply provide a classification of all the various items which are considered as taxable income. The classifications are modified from time to time in accordance with administrative, political or economic considerations. The Income Tax Codification Committee stated clearly that British Financial Acts imposing income taxation nowhere contain any clear definition of what was meant by 'total income' or how it was to be calculated. The Committee in their turn did not attempt to define it, but after providing a complete classification of all the various kinds of income which were taxable they stated that "what is meant by the total income of an individual is the net aggregate amount of income of the various Classes in respect of which he is liable to bear tax and is not able to pass on the liability to any other person".<sup>2</sup> The Income Tax is that by which the ultimate burden rests on the beneficiary, but not the recipient. The Committee on the Taxation of Trading Profits emphasised the view of the general scheme of British

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1. Simons, op. cit. p.103

2. Report of the Income Tax Codification Committee Cmd.5131,  
Vol. I. p.31



Income Tax legislation as "being not to tax anything but income" and thus "capital increment as such being outside its scope".<sup>1</sup> But what is capital is not defined and it seems that it is not easy to draw a demarcation line between income and capital. The Egyptian and French income taxes left the definition of taxable income more vague. In both of them, the words 'revenue' and 'income' were often used to mean the same thing and as a whole to cover the return of the factors of production as well as any realised capital increment or any distribution of corporation reserves.

The Conception of income prevalent in Britain, Egypt and France could be studied through their classification of income.

In Britain, income is categorised for income tax purposes under five schedules, the first, Sch. A., comprises income derived from the enjoyment of property, i.e. rent; the second, Sch. B., includes income from the occupation of land, i.e. the return of the tenants; the third, Sch. C., deals with income realised from funded property, in other words from public revenue, dividends and shares; the fourth, Sch. D., covers income arising or accruing from industry, trade and profession, in addition to other gains not being specified under any other schedule; and the last, Sch. E., refers to earnings from employment, annuities and pensions. In 1949-50 farmers occupying land of a gross value not exceeding £100, who hitherto had been assessed under Sch. B. were

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1. Report of the Committee on the Taxation of Trading Profits  
Cmd. 8189, p.7

transferred to Sch. D. This meant an almost complete cancellation of estimations under Sch. B.<sup>1</sup>

This classification is not logically arranged, and brings together matters having no intelligible connection. "On the one hand, it invalues the distribution of income of the same nature among different Schedules" and on the other includes income of a different nature in one schedule.<sup>2</sup> Per contra, the Egyptian and French Acts are clearly drafted and logically arranged. In the two countries income is classified according to the nature of the source. This facilitates the study of the taxation system and easily gives one a fairly complete and accurate grasp of their scope. There is a section for income derived from movable capital, a second on income derived from commercial and industrial profits, a third on profits from non-commercial professions, and the fourth on earnings of the nature of salaries, wages, pensions and the like. The French system includes profits from agricultural operations, an item which is absent from its Egyptian counterpart. Income from land and dwellings is dealt with through separate Acts. It is included in Land and House taxes in Egypt and 'impôts sur revenus faneiers des propriétés bâties et non bâties' which have been included with the schedular taxes since January 1949 under the name of 'impôt sur le revenu des personnes physiques'.

Logical or illogical classification is not significant. The main

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1. The provisional assessment of net true income under Sch. B. in 1949-50 reached only one million pounds see Inland Revenue Report, 1950. Cmd. 8103, p.37.
  2. The Report of the Income Tax Codification Committee p.27.

difference between the three systems is the elasticity which each gives to the concept of income, and the manner of assessment. It is clear from the British Tax that it is limited to income. Capital gains except those from professional speculations are regarded as mere accretions of capital. In the case of business profits it is stipulated that "as near as practicable the taxable profits should be no more and no less than the true "ones as computed on established accountancy principles".<sup>1</sup> Moreover, casual profits are also excluded from the tax.

The Egyptian and French systems interpreted income on a wider scale. They considered as taxable income any distributed benefits from reserves, as well as any increment received from the sale of any asset.<sup>2</sup> The State Council (le Conseil d'Etat) sanctioned in 1930, the theory of utilisation, but the tax administration fought a battle against that decision and the theory of 'balance sheet' was endorsed by Acts in 1932 and 1944.<sup>3</sup> In addition to the tendency to tax capital increment, casual profits and gains from whatever operation are also taxable. The differences between restricting the concept of the taxable income in Britain and stretching it in Egypt and France seems to be a result of striking income as a unit in Britain and taxing separately the returns of all income sources in Egypt and France.

c. Actual and estimated income:

The superiority of the British Income Tax is clear from its

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1. Report of the Committee on the Taxation of Trading Profits p.7
  2. Bocquet, L: L'impôt sur le revenu cédulaire et générale. Tom. II e, p.139 and Laufenburger, Traité op. cit. pp.44 et seq.
  3. Laufenburger, Ibid, p.41

fundamental reliance on the actual income rather than the estimated one. This practice reduces evasion and accomplishes justice as between the taxpayers. In the Egyptian Schedular Taxes people are charged on their actual income. Before 1951, the liberal professionals were taxed according to the rental value of professional premises which was used as an indicator to their profits. It was alleged that this privilege was given to appease this politically powerful section of the taxpayers rather than for any administrative reason.<sup>1</sup> Practical difficulties and socio-political pressure seem to have influenced the French legislator in relying upon income estimates in taxing artisans and agricultural profits. This arbitrary system known in France as 'forfait' is far from just. It distributes the tax burden according to fictitious assumptions.

The defect of depending on estimated income becomes serious with every increase or progression of the tax rate, since a section of the taxpayers are favoured at the expense of the others.

The criticism of the arbitrary assessment of income compelled the planners of the General Income Tax in Egypt to avoid it when it was administratively possible. The taxpayer is now assessed on the rental value of his dwellings or land unless he can produce accurate accounts of his actual profits from these sources.

#### d. The unity of income taxation:

The unity of income is the first step towards universality of

1. The taxable income of professionals was taken to equal 7.5% or 10% of the estimated rental value of the premises they occupy in following their profession. The Law No.146 of 1950 imposes the tax according to the real income realised from profession.



distribution of the tax burden and towards the application of the principle of ability. Once income is treated as a unit, then abatements and progression can be effectively carried out, and double taxation can be avoided. According to Stamp, "A proper tax upon incomes is hardly possible in a community that is not fairly advanced, both in its people and its government".<sup>1</sup> Personal declaration of income is necessary and unless the people have a high civic sense, the burden of the tax will swing against the honest. This was the reason for the old fear that once the individual is trusted to make his declaration of income, the treasury would be left to the mercy of his whim, and would be in a position to judge for himself, what is the just share to be contributed for public purposes. The absence of the characteristics of a well-balanced society, a highly advanced people and good government would lead to a reliance upon presumptive taxes or conventional expedients.

The British Income Tax is not a tax upon income but upon persons according to their respective incomes. This is what makes it more progressive than the taxes in Egypt and France which treat income objectively. The unity of the British Tax was achieved by the Finance Act, 1927, which modified the method of calculating the tax in such a way as to assist in assimilating the Income Tax and the Super Tax so as to make a single duty. The French reformed their system and unified their schedular income taxes under 'the tax on physical persons'. But each source of income still has to pay a separate proportional tax and

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1. Stamp, J: The Fundamental Principles of Taxation, p.22.



then the total income is subject to a surtax following a progressive scale.

The Egyptian system is following the old French system. It treats the returns of each source as a separate entity. The objective outlook is then the dominating feature of that system except in the case when the return is derived wholly or partly from labour when it is looked upon subjectively. The Egyptian Schedular Taxes have been supported since July 1949 by a progressive tax which is imposed on the total net income of the individual. This is a step towards unifying income taxation.

Ideal income taxes impose equitable relative levies upon individuals. This personal characteristic of the tax suggests two different lines of approach; either to treat the cumulative family income as the taxable income unit, or to consider the income of each physical individual as the unit. If we adhere to the former line, the exempted marginal income should be comparatively high, and progression should be less steep than if we approve the latter line.

The income taxation systems varied in this point because of differences in the mode of life, in the constitution and in the status given to the wife. The old rule in Christian World was to incorporate the wealth of the husband and wife as a guarantee for commercial liability. Contrary to that practice, in the Islamic World women rank *pari passu* with men and their property is separate; marriage does not alter anyone's position in this case. According to the British and French legislation,

the rule is that "the husband and wife when living together are to be regarded as one unit for the purposes of taxation".<sup>1</sup> If the wife gained a profit, while living with her husband, such a profit would be deemed as a profit of the husband.<sup>2</sup> This will lead to the assumption that any loss sustained by the wife should be set off against the husband's profits. On the other hand if a married woman were living separate from her husband, or applied for separate treatment, she could be assessed and charged as a 'feme sole'.<sup>3</sup> This privilege is not absolute because in Britain, for surtax purposes, the income of the people is treated as one and the amount of the surtax payable in respect of that is divided between the two in proportion to the amounts of their respective incomes.<sup>4</sup> Such a reservation is made to stop any evasion of the high rate of surtax. The separation of the property of a couple, by declaration or through divorce, in France gives each one the right to separate treatment for the general income tax as well as the progressive surtax (surtaxe progressive).<sup>5</sup>

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1. Report of the Income Tax Codification Committee, p.81 and Formery L: Les Impôts en France, Tom Ie, pp.276-7
  2. Report, Ibid, p.80
  3. The British legislation stipulates that a woman is treated as living with her husband unless they are separated under an order of a court of competent jurisdiction or by deed of separation or they are in fact separated in such circumstances that separation is likely to be permanent. See Draft, Income Tax Consolidation Bill Cmd.8174 pp.270 & 276; The Report of the Codification Com.p.80 and Formery op. cit. p.276
  4. Income Tax Consolidation Bill, p.271
  5. An attempt to impose the General Income Tax in Egypt on the joint income of the family was refused by the Financial Committee of the House of Deputies on religious basis. Cf. Collection of Taxation Laws by Hasaballa, N: (in Arabic) pp.37-8.

The income tax legislation in Egypt follows the Moslem ruling and treats the wife separately from her husband. In the meantime, she cannot claim any family allowances if married, unless the husband is incapacitated, or unless he is dead, or if she legally bears responsibility for them. This restricted rule is based on the principle of the absolute legal responsibility of the man towards his family.

The practice of taxing the joint income of the family imposes the greatest injustice upon the majority of married people. Married couples are penalised, by being taxed at a much higher rate than if they were single, or if they were living together but unmarried. This arrangement is also criticised because of its contraction to the spirit of 'The Women's Property Act' which gives married and single women alike the right to be independent and in control of their own finances. It seems also to have a deterrent effect on married women who take part in industry and trade.

Married couples could be relieved if they were given an exemption equal to double that of a single individual, and allowing them a reduced rate at any income level, "as the income goes up through graduated-rate brackets".<sup>1</sup> This solution would not rid the tax system from the injustice borne by taxing the joint income and its practical inconsistency. Shoup suggests that "the married couple's total net income must be divided into two equal parts, each part being taxed separately".<sup>2</sup> But it would be more reasonable if each individual is required to file a

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1. Groves, H.M: Viewpoints on Public Finance, p.203.

2. Ibid, p.207.

separate return of his income and taxed accordingly, and in this case, the exempted margin could be curtailed in general.

e. The time element in income taxation:

The time element is important in determining taxable income. It is almost an ordinance of nature to measure income by year which, apart from its appropriate reflection of relative ability, is in practice convenient to the State. In Britain income is thought of as an annual amount, and only the annual returns are subject to taxation. But the word 'annual' is not a distinctive feature of the Schedular Income Taxes in Egypt and France. Income from movable property is taxable when it is realised, without any consideration of the period, and wages per day are subject to the tax when they are earned in Egypt. Moreover, casual commissions or brokerages are subject to the tax in Egypt. During the last war any profit arising from any cotton operation was also liable to the tax, without reference to the duration of profit. The Egyptian and French practice is criticised as violating the principle of justice in distributing the tax burden. When the tax is levied on any casual profit or earning, it ignores the subjective element of the tax and does not provide any reduction for subsistence or allow anything for family upkeep.

This practice is different from the P.A.Y.E. system of Britain,<sup>1</sup> according to which taxation is deducted at the source from monthly or weekly earnings of employees, and an exact balance is made at the end

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1. Before 1914, it was considered that manual and weekly wage-earners would be better able to contribute through outlay taxes because of the difficulty of collection of direct taxes on their income. Quarterly and half-yearly assessments were adopted from 1925 till 1943, when the P.A.Y.E. system was brought into operation. See Pigou, *A Study in Public Finance*, p.116.



of the year, and the tax is adjusted by means of additional payment, or a refund according to the real rate the employee is subject to. In spite of the convenience realised from deducting the tax at the source, the P.A.Y.E. system causes an enormous addition to the work of business concerns and the Inland Revenue Department. A proposal for amalgamating the P.A.Y.E. scheme with that of Social Security will be discussed later on.

Even if annual assessment is considered to be an acceptable basis, there are different measures of annual income. Up to 1926-7 the normal basis of assessment of business in Britain had been the average profits of the three years preceding the year of assessment.<sup>1</sup> Since then the basis has been the actual income of the preceding year. In some cases the tax is levied according to the actual income of the same year. There is a wide dispute as to the preferability of basing the assessment on the current year or of a return to the average system. The former seems to be logical and in conformity with State's annual needs; the latter, on the other hand, is favourable to the new and expanding business; it also gains credit for being more equitable to those whose income fluctuates widely from one year to another, in a country like Britain where high progressive taxation exists.<sup>2</sup> The average system is criticised for causing lags in the yield when profits are increasing or declining and making the tax excessive in relation to the actual profits.<sup>3</sup>

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1. Report of the Committee on the Taxation of Trading Profits, p.9

2. Ibid p.10 and Stamp, op. cit. pp.27-8

3. Spaulding, op. cit. p.222



It destroys uniformity in assessment and makes the charge at a point of time far from that at which the profits arise.

The preceding year basis is that applied in the Egyptian and French Schedular Taxes.<sup>1</sup> In some cases where income is taxed at the source, the taxpayer is charged on the income received in the year of assessment. This involves an assessment of taxation before the total income is known, and is criticised as raising certain difficulties in meeting claims for refund when the effective rate is less than the charged tax.<sup>2</sup> In the years when the value of money fluctuates, it is much better for the State to impose and collect the tax at a time very near to that at which income is received. "Where money values are falling, taxpayers under the average system have a distinct advantage and vice versa".<sup>3</sup>

The annual assessment, under whatever system, allows for continuous change in the taxable income. It is still much better than the 'old' system of fixing the taxable charge for more than one year and giving no weight to any change in income. In Egypt, up till the present time taxable rental value of land is fixed for ten years, and in the case of houses, the estimated taxable rent stands for eight years. In France arbitrary estimates of the profits of artisans and from agriculture are made every two years. The same practice was applied in Egypt up till 1944 in cases where the concern did not keep accurate accounts. Such a system is based on fictitious profits, and sacrifices justice for administrative ease.

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1. It is stated in the French 'Surtaxe Progressive' that "Il est dû par toute personne...et dont la part de revenu net total de l'année précédente..." See Memento Fiscal p.60

2. Spaulding, op. cit. p.215

3. Ibid p.223

f. Corporate income subject to taxation:

Corporations in Britain and Egypt pay income tax at a standard rate like any other individual, before any distribution of profits takes place. In this manner, the corporations are not considered as taxable entities, but merely agents for their shareholders. The continuous increase of State's need for revenue has caused a departure from this theory in Britain, and corporations are now considered as potentially taxable units and made subject to profits and excess profits taxes, in the same way as they have long been treated in France. The French justify the imposition of income taxation on corporations on a legal view. A corporation has a separate legal identity quite apart from its owners. It has a separate capital and its obligations are likewise separate.<sup>1</sup> When corporations are made subject to taxation, the characteristics of personal taxes in the way of exemptions, individual allowances and progression become out of the question.

For income tax purposes, each corporation in Britain is treated as a unit, while for profits and excess profits taxes 'group treatment' is allowed and is sometimes compulsory. For Profits Tax "where a parent company...owns directly or indirectly, not less than 75 per cent of the ordinary share capital of a subsidiary it may elect to have profits or losses of the subsidiary treated as profits or losses of the parent company". For E.P.T., 'group treatment' is allowed when the parent company owns 90 per cent of the capital of the affiliated company.<sup>2</sup>

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1. See Laufenburger, *Traité* pp.213 et seq.

2. Report of the Committee on the Taxation of Trading Profits p.95

This practice is suggested for Income Tax purposes, as lessening the severity of that tax, but it is feared that this concession might be exploited for the purpose of tax evasion.

According to the Egyptian legislation the Commercial and Industrial Profits Tax (Com. and Ind. P.T.) is imposed on the net profits resulting from all the operations carried out by the taxpayers, which would eventually lead to 'group treatment'. In other words the profits and losses of different companies could be accumulated in one account subject to one tax. But this rule is not wholly observed by the Taxation Department which, being forced with the exemption of charitable, religious and other non-profit making concerns, had to impose the tax on the separate legal concerns being run for profit.<sup>1</sup>

In France, corporations are treated as separate legal units subject to taxation (*l'impôt sur les bénéfices et revenus des sociétés et autres personnes morales*). 'Group treatment' is allowed in order to stop any drift towards double taxation.<sup>2</sup>

For income tax purposes, a corporation is considered in Britain and Egypt as "a device by means of which a number of individuals can conveniently do business".<sup>3</sup> The Income tax and the Com. and Ind. P.T. in practice bear upon the undistributed profits. If part of their income is thought to be unreasonably accumulated by the corporation, the Inland Revenue authorities might ask for an apportionment of that

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1. This course is legalised by Law No.146 of 1950

2. Laufenburger, op. cit. p.224

3. Spaulding, op. cit. p.87

amount among the members of the corporation in order to subject it to Surtax.<sup>1</sup> A similar measure against tax evasion is taken ~~from~~<sup>for</sup> Profits Tax purposes, when the director's remuneration in the case of director-controlled companies is limited to £2,500 per annum or 1% of the profits subject to a maximum of £15,000 per annum.<sup>2</sup> In Egypt, the deduction from the taxable profits of corporations of any part of income derived from invested capital forming part of the assets of any undertaking, is allowed. The same procedure is accepted in Britain; income received directly or indirectly by way of dividend or distribution of profits from a body corporate, being excluded from the profits liable to Profits Tax.<sup>3</sup> This provision seems to be as a measure to avoid double taxation.

g. Nationalised corporations and municipal trading bodies.

Neither the British nor the French Income Tax system exempts nationalised corporations or any municipal trading body.<sup>4</sup> This is justified by the argument that any exemption would give public bodies an unfair advantage over private traders. Moreover, it is claimed that tax exemption can add an additional advantage to the existing monopoly. Faced with the obligation to pay taxes, the public bodies could be compelled to reduce the price of their service to what is enough to cover the marginal cost. Besides, the charges "may be a useful payment to public revenue unconsciously borne by the community which it is unwise to disturb".<sup>5</sup> In Egypt, public undertakings are not taxed.

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1. Ibid, pp.87-8

2. Report of the Committee on the Taxation of Trading Profits, p.104

3. F. A. 1947.

4. Spaulding, op. cit. pp.151 et seq., F.A.1947 and Memento Fiscal pp.55 et seq.

5. Stamp, op. cit. p.36



It is held that the corporation works predominantly for profit which should be taxed, and this is not the case in public concerns, which work for national benefit. The taxation of public corporations serves no object because the Minister of Finance could draw on the reserves of these corporations when necessary. In the case of municipal enterprises, the surplus in their trading is necessary to enable local bodies to carry their obligation to the public on behalf of the Central Government. If re-allocation of the resources from one area to another is not intended, the tax would merely mean a waste in keeping accounts for taxation and engaging public servants in unnecessary work.

h. The determination of taxable profits:

The determination of taxable profits in the case of corporations varies according to the nature of the tax. For the ordinary income and profits taxes, the taxable profit is that part realised from business activities. A difficulty might arise, when a system of schedular income taxes exists, if the profits of the concern came from sources which have been taxed previously. In this case any part of the revenue which was previously taxed is to be exempted.<sup>1</sup> In the case of the E.P.T. the taxable profit of a corporation might be determined by an average basis of some years, considered as normal, or a proportion of the working or invested capital during the year of

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1. In Egypt it was made clear that the revenues on movable capital or derived from cultivated lands and buildings, or exempted from taxation by virtue of any law, which are comprised in the assets of the concern, will be deducted from the total amount of the net profits liable to the tax on profits to the extent of the total amount of these revenues after deducting their contribution in the expenses and charges of utilisation on the basis of 10% of the amount of the said revenues. Art. 35 and 36 of the Law 14/1939.



assessment.

The conception of average profits covers a variety of things such as economic rent, variations in capital employed, fluctuations of risk etc.,<sup>1</sup> but on the whole it does not raise difficult problems, as in the case of a proportion of a capital. There is a confusion between the working and invested capital, which were often used in E.P.T. and in accounting discussions.<sup>2</sup> Working or rotating capital could be interpreted as that liquid part of the assets which could be used for running the enterprise, in other words it is the difference between the circulating assets and circulating liabilities.<sup>3</sup> Working capital fluctuates according to the nature of the business. The invested capital, which is sometimes called the capital employed, might be interpreted as the real capital owned by the corporation and utilised in all its activities, and would not thus include any borrowed money even if this money were employed in the business.<sup>4</sup> According to F.A.(2), 1939, the capital employed was defined as the assets acquired by purchase or otherwise, as well as debts due to the business. In Egypt no clear definition of invested capital was given, and it was only stated that the standard profit could be a percentage "of the actual invested capital including the reserve funds which may exist in the concern". Some taxpayers exploited this ambiguity in the Act and increased their assets, by leaving idle reserves in order to increase their standard profits. The

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1. Stamp, J: Taxation During the War, p.234

2. Ibid, pp.152 et seq.

3. Nawār, Y: Accounting and Auditing, Budgets Vol.III pp.140-1  
(In Arabic)

4. Ibid, p.149

British definition on the other hand, falls heavily on any business which depends on borrowed money to increase its activity, as such credits are not counted as part of the capital employed.

The inclusion of casual profits in taxable income in Egypt which it was thought at first, would eliminate evasion, was used against the Taxation Department when the E.P.T. was applied. The taxpayers claimed the right to add in their standard profits any casual gain.

It is clear that definitions for taxation purposes should be such as not to lead to any confusion, or disturb the basic principles of equity, or encourage evasion.

i. Intangible or psychic income and income in kind:

The income of an individual might be taken to mean what he actually receives in money terms. But this does not show the relative ability of individuals to pay taxation, because money income does not include all the gratuitous services enjoyed. If one lives in one's own home, helped by one's wife, and receives any material gifts, his real income is increased by the estimated value of these services and materials. To ignore this item is to increase the real exemptions and the real degree of progression.<sup>1</sup> It would facilitate evasion and discriminate between individuals. Fisher used the word 'psychic income' to mean all the agreeable conscious experiences,<sup>2</sup> and thus made it include all the items which render certain satisfactions to the individual or simply all tangible plus all intangible income. This psychic income might be the

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1. Simons, op. cit. p.113.

2. Fisher, op. cit. pp.167 and 333

best measure for the relative ability of individuals, but it could not be used for taxation purposes, except in an arbitrary manner, objectionable to taxpayers. A compromising attitude is followed, and taxable income is interpreted to include all income in kind which the individual receives which has a market value. According to Pigou, it is only "that part of real income which has a money counterpart" because "to bring in other parts would involve such high administrative costs as not to be worth-while".<sup>1</sup> Thus the service of the wife to her husband, the car to its owner and the casual gifts exchanged between friends, are not counted for taxation. Simons wanted to tax 'leisure income'. He said that "Income from consumers' capital is often a large part of total income for individuals in the upper brackets".<sup>2</sup> Its exclusion would introduce a bias inconsistent with the system of progression, differentiates against people of similar financial circumstances and facilitating the opportunity for evasion. This view might be important in our own difficult time when direct employment is more urgently required to balance the economy of the community; but Simons does not provide any accurate measure to calculate this 'leisure income' for taxation.

The extent of the widening of the conception of income, to include other benefits in kind, differs from one taxation system to another. In Britain, as a rule, accommodation furnished rent-free to an employee is not considered liable to taxation, except of course if it is sub-let

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1. Pigou, A Study in Public Finance, pp.77-8 ✓

2. Simons, op. cit. pp.113-4

to a third party.<sup>1</sup> This provision is not applied to State officers who are in apartments belonging to the Crown. It seems that this contradictory practice comes from considering the benefit in the first instance as related to the cost of running the business, and is necessary from the point of view of the concern, and, after all, value cannot be turned into money. In the latter case the officer is not obliged to use the apartment except in a very small number of cases and they enjoy the use of these tenements apartments as part of their remuneration. On the whole, the general conception of taxable income in Britain comprises money income and anything else capable of being turned to pecuniary account. The Income Tax Commissioners reckon as income, tips, Christmas bonus and gratuitous pensions. In addition to that, they assess for taxation the rental value of the house occupied by the owner, less an arbitrary depreciation allowance, and the amount of agricultural products consumed by the farmer from his farm.

The French system follows the lead of the British, and taxes all benefits in kind that could be valued in money. In Egypt all income in kind received by the taxpayer, in relation to the employment of any factor of production, is subject to the Schedular-Income taxes. It is stipulated in the legislation that taxes on earnings are assessed and imposed by virtue of a benefit in cash or in kind.<sup>2</sup> In the case of the tax on General Income the legislator is more lenient. He does not include the rental value of the home owned and resided in by the taxpayer.

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1. Spaulding, op. cit. p.156

2. Art. 62. Law 14/1939



Moreover, the taxpayer is allowed from his taxable income all losses sustained through bankruptcy, the previous three years losses being included for exemption. Also exempted are all grants provided to the State or to any charitable society approved by the State to a maximum of 3% of the annual income of the taxpayer.<sup>1</sup> These provisions which narrow the conception of income could make the tax ineffective.

j. Co-operative dividend:

The concept of money income raises certain problems as in the case exemplified by Pigou where a society or a group of people is arranged as to join together in a self-sufficing manner and where no money is used. In this case there is no taxable money representative of the real services that it renders.<sup>2</sup> The co-operative societies think that no profit arises if two individuals join together to serve each other, and thus that the co-operative dividend should not be considered as a taxable benefit.<sup>3</sup> Goods in the co-operative society could be distributed at the cost price, and thus the element of dividend would disappear. But the co-operative society fixes the prices above marginal cost for practical reasons, and there is no profit actually gained and thus co-operative discount and dividend distribution should not be added to the taxable income of the individual. This view is not accepted by the non-co-operatives who insist that those who enjoy the services of the co-operative societies have a greater ability to pay taxation. The three income tax systems adhere to the former view and exempt co-operative dividend from taxation.

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1. Arts 6 and 7, Law 99/1949

2. Pigou, A Study in Public Finance, footnote p.79

3. Stamp, The Fundamental Principles of Taxation, p.34.



CHAPTER IVTHE NATURE OF INCOME IN THE INCOME TAX FORMULA

(Continued)

I. THE JURIDICAL SPHERE:

The problem of liability to income tax is one of the obscure points which is embodied in modern income tax structure. A person might belong to a certain nation, be permanently resident in a foreign country and invest part of his capital in a third. He has then certain obligations towards the three countries, but in the meantime, they have liabilities towards him. Unless a solution is discovered to relieve him from double taxation he will be left in bewilderment. The international law which limits the power of any State to its juridical boundaries does not provide sufficient guarantee in this case. If one agrees with Stamp the "State can tax beyond its borders in respect of property it protects".<sup>1</sup>

If we set aside the juridical difficulties which arise from historical, economic or social conditions and try to determine an acceptable and just formula for taxation, we will be faced with the conflict between 'situs' and 'ownership' or 'the residence'<sup>2</sup> and 'origin'. Moreover to apply any taxation principle, we will find ourselves tottering between the 'benefit' and the 'ability' principles. Any tax legislator will be indifferent towards the basic principles of taxation, whether the tax should be on things or persons, and whether they should be on the real or estimated income. He might try to search for the tax

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1. Stamp, op. cit. p.126

2. Ibid, p.117

formula which seems to strengthen his own country's case; but to do even this is not an easy task. The interests of the creditor country are different from those of the debtor, and to disregard this might encounter the State in an awkward position. Sometimes tax legislation is carelessly drafted and leads, intentionally or unintentionally, to international double taxation which is by no means desirable for the welfare of the world. The study of the different systems however complex they may be, will reveal the degree of strength, influence and effective administration of each.

The problem of liability to the present systems of income taxes in Britain, Egypt and France rests on three important criteria: citizenship, residence and the source of income.

i. Citizenship: Every citizen has a constitutional right in his country and can claim all privileges rendered to his countrymen. This is not sufficient reason for the British tax legislator to subject British citizens to income tax whether resident in Britain or not. Exemption does not include such amounts which are derived from within Britain.<sup>1</sup>

The French system goes a little further and imposes the tax on the citizens who are not permanently domiciled in France but have a residence there. They pay an income tax on an arbitrary amount equal to six times the rental value of the premises at their disposal.<sup>2</sup> The Egyptian citizen is rather at a disadvantage. He is subject to General income tax wherever he may reside.<sup>3</sup> The Egyptian national, whether individual

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1. Vasilu, V.G: The Income Tax in Great Britain and Roumania, p.241

2. Memento Fiscal, p.61

3. Art. I Law No.99 of 1949

or incorporation, is also subject to the tax on the profits, interests and redemptions paid to him by foreign establishments.<sup>1</sup> Excepted from this rule are all dividends, interest and other profits derived from movable foreign values which Egyptian insurance and re-insurance companies keep in deposit abroad, to constitute a guarantee or actuarial reserve or any other reserves for the purpose of meeting all risks involved in such operations. The French legislator grants this privilege only if such reserves are deposited in accordance with foreign legislation.<sup>2</sup>

The liability of an Egyptian to income tax simply because of his nationality may easily lead to double taxation and put him in an unfavourable position. The case of taxing foreign movable products is justified on the principle that these products were the outcome of investment of Egyptian capital, and that such a tax might possibly divert Egyptian investors from foreign countries and induce them to invest in the home market.<sup>3</sup> But this is far-fetched reasoning and would not be any guarantee against fraudulent evasion.

ii. Residence: To the citizen the tax is his share "which the State appropriates in order to procure for itself the means necessary for the production of general public services".<sup>4</sup> But the outlook of the foreigner who resides in a country is different. He looks at the tax as the price he has to pay for the specific protection and maintenance conferred on him by the State and his sources of income. Residence in a country makes one liable to the income tax imposed on it. This principle

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1. Art. 5, Law No.14 of 1939

2. Al Rifaei op. cit. p.261

3. Ibid p.269

4. De Marco, op. cit. p.111.

is adopted in nearly all tax legislation. At one time in the history of Egypt, up till 1937 as has been noted, 'foreigners' were exempted from all taxes on income according to the interpretation of the 'Mixed Courts' of the terms of the Capitulations. But by the Montreux Agreement such unjust privilege was terminated. Tax legislators vary their definition of the meaning of residence in regard to the individual and the Corporation.

a. Residence of Individual:

The meaning of residence in Britain is a disputed question and the existing acts and regulations provide no clear cut definition to assist in its solution. In the case of the individual, he might be considered resident if he stayed in the country "at one time or several times for a period equal in the whole to six months in any year of assessment" and the liability will be limited to that year of residence.<sup>1</sup>

The time as so specified is not sufficient indication that the person is residing in Britain because one must understand first the reason for the person's presence in the country, as he might be a tourist, a student or a patient. Another question which might be raised is to what extent evidence of residence could be taken from the person's attitude before or after the year of assessment. Besides, a person might be resident but due to the spread of his business he might not stay in his country for six months in the year. The Codification Committee held the idea that probably the Acts were drawn at a time when "transport

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1. Report of the Codification Committee, Vol.I, p.35



facilities were rudimentary and the mobility of the population almost negligible".<sup>1</sup>

To overcome the former difficulties the regulations were stretched widely and take as a resident one who maintains a place of abode in Britain available for his use. He is taxable for any year in which he pays a visit even if it is shorter than six months, so long as his visits became habitual year after year.<sup>2</sup> One well-known definition of residence in Britain was given in the case of *Lloyd v. Sulley* in 1884, viz. that the place of residence is that in which the individual can set himself down with his family and establishment, even if he occupies it for only a portion of a year.<sup>3</sup> The residence in Britain is within the ambit of the income tax on all his profits, whether realised in Britain or not, unless there is any bilateral agreement or the like by which income from a foreign source is exempted. The long practice of British taxation has carried the problem to the point of argument as to whether to accept 'residence' as such as sufficient qualification for income tax or whether it should be limited to 'principle residence'. This latter suggestion might be of importance in stopping a drift to double taxation. It was emphasised in some legal cases that the liability of a resident to income tax on the part of his income derived from foreign source, depended on whether he were engaged in the conduct of the business or not. If he were not, he would be charged only, that part which he received in Britain; but if he were, he would be liable

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1. Ibid, p.35

2. Ibid, p.36

3. Vasiliu, op. cit. p.237-8



to the tax on all his income whatever the situation of the business.<sup>1</sup> This resolution was taken to solve the problem of the professional who might conduct activities outside his place of residence and the people who owned shares or participated in foreign corporations.

In Egypt, residence is considered sufficient for subjection to the tax on the yields of movable property and also to the general income tax. The Schedular Income Tax Act made taxable "foreigners domiciled or habitually residing in Egypt".<sup>2</sup> But the Act omitted to give any definition of 'domicile' or 'habitual residence'. It was feared when the Bill was drafted that such a definition might cause unwanted difficulties. Dr. Al Rifaei holds the view that the foreigner can only be considered resident if he intends to stay in the country.<sup>3</sup> Accordingly, tourists, students and those who stay to make scientific experiments are not taxed on what they receive from outside Egypt. It seems that this interpretation is still vague and unsatisfactory. One's intention does not lead to a precise meaning from which a tax collector can draw a conclusion as regards liability to taxation.

The legislator defines residence more clearly in the General Income Tax. A foreigner is considered domiciled if he has made Egypt the centre of his residence and activity.<sup>4</sup> If the foreigner is domiciled in Egypt, he will be treated in the same way as a national and be subject to the tax on his aggregate income wherever its source.

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1. Spaulding, op. cit. p.48

2. Art. 4, Law No.14/1939

3. Al Rifaei, op. cit. pp.269-70

4. Art. 2, Law No.99/1949

The French legislation subjects all residents to the General Income Tax. The resident is stated to be one who keeps a lodging for his use or possesses any property for a year at least or one who makes France his main residence.<sup>1</sup> The Frenchman who habitually resides in France pays the tax on all his income realised in or out of the country. The income of the domiciled foreigner is treated in the same manner with the exception of the amount of income which he may have gained from foreign sources, and he has to pay on it a general income tax. This attitude is rather more moderate than the British or Egyptian practice.

The Frenchman who is neither domiciled nor habitually resident in France is subject to the tax on the part he has earned in the country. He also pays the progressive surtax;<sup>2</sup> and it seems that he enjoys all the abatements and allowances, unlike his British counterpart who cannot benefit from them unless he is resident in Britain.

#### b. Residence of Corporations:

In the case of corporations the definition of residence seems to be much clearer than in the case of individuals because of the material evidence that can be taken as an indication. Some of the indications are: the directors' meetings, the keeping of the corporation's accounts and the issuing of balance-sheets. Lord Sumner stated in the case of *Todd v. Egyptian Delta Land and Investment Co.* that "the word 'resident' with its various qualifications 'actually', 'ordinarily', 'temporarily' and so forth, is used in a sense in every way appropriate to natural persons, but only artificially applicable to incorporated persons, and

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1. Laufenburger, op. cit. pp.150 et seq.

2. Ibid, p.154

never really appropriate".<sup>1</sup> A Corporation may not act physically like an individual, but it "keeps house and does business".<sup>2</sup> It is on this point that the British practice is centred and the principle of 'control' adopted. A Corporation may have more than one 'place of residence' but it can only have one place of chief control. No consideration is thus attached in the British system to the place of registration or country of origin. The profits of a corporation are thus taxed, so long as it is controlled in Britain.<sup>3</sup> Subsidiary corporations in foreign countries are treated as having a special identity and are exempted, unless they are directly managed in Britain, or if they are mere shams to cloak the activities of a British corporation.<sup>4</sup> But on the whole the holding of the total amount of another corporation's shares does not stand as sufficient indication that the holding corporation is from the taxation point of view controlling the subsidiary one. The 'doctrine of control' does not clarify all the problems which may arise when the head office of a corporation is in Britain but its main activities are carried in another country as in the case of the Anglo-Egyptian Oil Field's Co. which was compelled to pay the British Income Tax because it was considered as directed from Britain and the Egyptian Tax because it was resident in Egypt according to the Egyptian legislation.<sup>5</sup>

The Egyptian Income Tax legislation treats as resident any

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1. Quoted by the Income Tax Codification Committee Report Vol.I. p.39
  2. Spaulding, op. cit. p.52
  3. Report of the Codification Com. op. cit. p.40
  4. Spaulding, op. cit. p.53
  5. The Company transferred its head-office to Egypt last year, the double taxation problem being one of the reasons.

corporation which conducts business in Egypt, even though its legal head office or administrative board is outside the country.<sup>1</sup> According to the Egyptian Companies Act, all joint stock companies formed in Egypt shall be called Egyptian and treated thus. This means that such companies shall pay the tax in full on all their distributions; dividends, interest and other profits derived from shares, etc. The same rule is applied to the foreign corporations resident in Egypt which distribute certain dividends outside the country.<sup>2</sup> If the foreign corporation carries on business in countries other than Egypt, it is considered to have distributed in Egypt an amount equivalent to the total profits of the year subject to the tax on Com. and Ind. Profits after setting aside 10% as a special reserve.<sup>3</sup> The resident corporations are also taxed on their undistributed profits and pay the tax on such profits again when they are redistributed or transferred from the country. The tax on Com. and Ind. Profits which a resident corporation has to pay is only on profits realised from operations in Egypt.

The treatment of corporations in France is similar to that in Egypt with a few modifications.<sup>4</sup>

iii. The Source of Income: The country from which a person draws a profit or interest is justified in taxing him simply because he has benefited from the protection and the exercise of law of that country, But to determine whether an income is obtained from within the country is not so easy as it may seem. Under modern complication conditions of

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1. Art. II bis. Law No. 39/1941

2. Art. 3. Law No. 14/1939

3. Art. II, Law No. 14/1939 as modified in 1941

4. Al Rifaei, op. cit. pp.263 et seq.



international trading, a person may be engaged in a series of transactions and capital may be used to finance some operations located in different countries, so that the place in which the profits are realised becomes difficult to ascertain for fiscal purposes. A contract might be signed in one country, the payments might be effected in another and the goods might be purchased in a third. There is also the problem of agencies which work for foreign firms. Their accounts do not show any clear profits like those of tourist film trade and of purchasing raw material agencies.

The problem is partly solved by the British adherence to the 'doctrine of control'. If the seat of business control is within Britain, the taxpayer is liable to be assessed for Income Tax on the profits of the whole of its trading operations wherever they are carried on".<sup>1</sup> The remaining problems are dealt with in Britain, either according to bilateral conventions or by determining whether a trade is exercised in Britain and then taxing the non-resident as if he were a resident.<sup>2</sup> If the trading profits cannot be ascertained, they may be estimated on a percentage of the turnover as is the practice in Egypt. There is no problem about the case of individuals who receive income from foreign public offices, because it is accepted in the tax legislation of almost all countries that the State which provides the emoluments, pensions or salaries, subjects them to its tax, wherever the receiver resides. The

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1. The Royal Commission on the Income Tax of 1920 quoted by the Codification Committee, op. cit. p.42.

2. Spaulding, op. cit. p.55



same rule is applied in the several systems in the case of emoluments paid by any office or individual, other than public, for duties performed in the country.<sup>1</sup>

Egyptian legislation raises acute problems with reference to the Tax on Com. and Ind. Profits. That tax is only payable on profits realised in Egypt and not otherwise, and thus individuals and corporations can divide their operations between that country and others. This raises many complicated difficulties and increases the possibility of evasion. The factors of the place of contract, the place of delivery of goods and the place where the payment is made, might be employed to limit the scope of the problem but cannot solve it altogether. In spite of this major defect in the Egyptian legislation, the system taxes the profit that might arise from any casual transaction in Egypt, thus limiting tax evasion.

French legislation is very clear in the matter of taxation of profits which are realised by French residents without distinguishing between the parts realised within and outside the country. In the case of agencies and other foreign subsidiary corporations, their taxable profits are estimated by various arbitrary means.<sup>2</sup>

The non-residents who are liable to the British tax are not entitled to personal allowances and other abatements except in special cases, e.g. in

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1. Codification Com. Report p.54 and Egyptian Schedular Income Tax Art. 61

2. Memento Fiscal p.14

the case of those who are British subjects, or individuals in the service of any Missionary Society, or any native State under British protection, or those employed past or present by the Crown, etc.<sup>1</sup>

The Egyptian and the French systems, on the other hand, do not raise such issues and they provide the exemptions when the individual is entitled to them without considering his residence.

## II. DEDUCTIONS ALLOWED.

The real income at any period of time is the 'net' inflow that accrues or generates during that period.<sup>2</sup> The word 'net' is very important as it indicates that an allowance should be provided to keep the factors of production intact, or materially as productive as before. It also means that the separation of product from the source was enacted and that the tax could be levied without fear of evasion or double taxation. De Marco put this point clearly when he stated that "the translation of gross into net income, ... is merely a technical accounting procedure, by means of which the total quantity of direct goods produced annually in a country and the corresponding total tax-burden are divided among those engaged in production and among the taxpayers" in such a way that "no part of so-called gross or total income escapes taxes on income".<sup>3</sup>

It is necessary to define 'net' income in such a way that the definition will carry the same meaning to the various taxpayers who

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1. Spaulding, op. cit. p.57

2. Pigou, A.C. Income, p.2

3. De Marco, op. cit. p.221

derive their income from different sources. A clear definition is also important in order to gain the practical objective of the tax as the distribution of the burden under any principle largely depends on what is allowed for deduction from the gross income. The degree of perfection in any tax scheme can be measured by its success in this particular point.

The notion of 'net' income is not clear cut, because the notion of keeping capital intact, which is insisted upon, is not itself clear.<sup>1</sup> According to Marshall, net income can be found by deducting from gross income "the outgoings that belong to its production".<sup>2</sup> This general principle cannot settle the dispute which may arise between the tax collector and the taxpayer in differentiating between 'income cost' and the disbursement of income. Net income is not a precise entity of a known nature. "It is a portion of gross output selected and marked off from the rest by a boundary line" determined by our own choice, and in no way an objective fact.<sup>3</sup> Hicks regarded a person's income "as the level of a standard whose present value is the same as the present value of his prospective receipts", or net receipts in the case of a firm. The net receipts, he stated, are equal to the surplus minus the charges arising out of past contracts, and to reach the profit, depreciation should be deducted or appreciation added.<sup>4</sup> The position might be simple if income could be clearly separated from its source, which is not usually the case. A crop, for instance, "takes away with it so much

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1. Pigou, A.C: The Economic Journal Vol. 45, 1935, p.235

2. Marshall, A: Principles of Economics p.72

3. Pigou, op. cit. p.240

4. Hicks, J.R: Value and Capital p.196

of the organic and inorganic elements" of the land,<sup>1</sup> and to restore its productivity we have to put back into the ground what each crop has taken, which is not easy to assess. Fisher admitted that there was a chasm between accountancy and economics, with reference to income, and it should be overcome to reach an acceptable solution for income tax purposes. 'Net income', he enclosed was equal to the incomings minus the outgoings. In simple terms his income formula was as follows: Aggregate income is the algebraic sum of a, the money received from all the person's properties less the money expended on them, plus b, the money received for the person's work less its psychic cost, plus c, the services rendered by his 'consumption goods' less the amount spent on them, plus d, certain services rendered by the person's body-mind to his stream of consciousness, less their 'real' cost, plus e, the services rendered by 'cast' namely its use in furnishing money, less its dis-services in absorbing money.<sup>2</sup> The services and some of the cost in kind he referred to, were those which could be measured or estimated in money terms.

Every factor of production is depleted or depreciated in one way or another through the process of production or through time. In our dynamic conditions it might even become obsolete. It is necessary then that we lay aside part of the output to compensate for this destructibility or loss of the assets of the community on which future production and progress depends. Someone may go as far as allowing

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1. Smart, W: The Distribution of Income, p.20

2. Fisher, J: Econometrica Vol. 5, 1937, pp.26-7

for irksomeness of labour and the risk-taking of the enterprise and even saving of the individual or corporation.<sup>1</sup>

The replacement of the loss in the value of the assets is one factor in determining the 'net' taxable income. They may not cause much dispute as accounting for the necessary expenses involved in the process of earning income. There are the expenses on food, clothing and shelter which are needed before any work can be done.<sup>2</sup> There are also the expenses on the instruments needed by a doctor, the books by a lawyer and the like.

Deductions from gross income to determine the 'net' taxable part differ in the various systems, and this is due partly to difference in the notion of income, partly to historical practice and accounting technique, and partly to the conception of equity. An analysis of some deductible items in taxation practice will disclose the differences in the treatment of income, and the degree of logic embodied in the taxation laws under discussion. Income tax laws impose the tax either on the income of the individual or the returns of the factors and this has its basis in the kind of deductions allowed.

#### i. Deductions allowed for the individual.

##### a. Minimum of subsistence:

The individual is like the machine, he needs a certain amount of materials for his necessary upkeep and to maintain his productive force. These needs differ according to the person's bodily metabolism and his

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1. Ibid pp. 32 et seq.

2. Pigou, Studies in Public Finance, p.80 ✓



environment. It is true that in such a case it is difficult to decide for any person beforehand as to his perpetual necessities. But in spite of that, one does not need to be precise, and an arbitrary estimation of one's subsistence level could be drawn so that taxation should encroach on its domain.<sup>1</sup> A minimum amount of income should then be allowed free of tax. Most countries agreed on this principle but they differ according to their estimation of that minimum. During a war or crisis, some writers think, the tax might strike at this minimum in order to keep the people aware of their responsibilities in the hard times being undergone.<sup>2</sup>

In Britain the individual is allowed free of tax £110 of his annual income which is increased by £70 for his wife, £60 for each child and £50 for a housekeeper. He can also claim allowances for a daughter's services or dependent relative according to the regulations. A married man is granted an additional relief of five-sixths of his wife's earnings up to a maximum of £110.

In Egypt it is assumed that the tax is levied on the returns of the factors of production and thus personal exemption is limited to the earned part of income. In spite of that the basic allowance is not uniform and the individual can enjoy a multiplicity of exemption if he has derived his income from more than one scheduled source.<sup>3</sup> The exempt marginal income since 1950 is £100 (£102.10.0) with an addition of

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1. Laufenburger, op. cit. p.189
  2. Groves, H.M: Viewpoints on Public Finance p.190
  3. To stop this multiplicity which is against the principle of granting personal allowances, an amendment to the law was made in 1950 preventing any taxpayer from enjoying more than one exemption. The effectiveness of the amendment seems to be doubtful so long as each source of income is taxed separately.

£20 for a wife and £30 for one child or more, if income is derived from any source other than movable properties and providing that the total income does not exceed double the amount of the allowance.<sup>1</sup> Moreover, small traders are entitled to an exemption of half the rate of the tax on Com. and Ind. Profits if their capital employed in the business does not exceed £200 or their profits are less than £300 per annum, providing that they have no other source of income, or employ in their business more than one labourer but they must keep proper accounting.<sup>2</sup> When applying the tax on general income the individual is allowed another £50 for his wife and each child under his care with a maximum of £200. This disunity in providing for family allowances in the Schedular Taxes and again in the General Income Tax results in some sections being provided for by more than one allowance.

The French system gives more attention to the basic exemption than its British or Egyptian counterparts, though the basic rates may be less than those applied in Britain. First of all if the income is earned through employment, profession or the carrying on of a business,

1. Before the law No.146 of 1950 that amount of exemption was only given on income derived from commercial and industrial profits. The margin in the case of income from salaries was £60 a year for each tax earner without reference to the size of his family. The liberal professionals were not allowed any income exemption because their tax was calculated according to the rental value of their premises.
2. This procedure which is applied by law No.146 of 1950 is quite logical. In addition to lightening the burdens of the comparatively poor traders, the measure is intended to encourage them to keep proper accounting and thus continuous dispute between them and the Taxation Department would be limited. According to the Industrial Census of 1945, about 66% of the industrial concerns either run by their owners or employ one labourer. As to commercial concerns, according to 1937 Census, about 92% of them had an invested capital less than £200. The number of those which were run by their owners was 75% and those employing between one and two labourers counted 18%. See The Pocket Book of Statistics, Egypt, 1947.

income up to 200,000 frs. (£204. 1. 7) is assessed for taxation at half that sum. But if the taxable amount is less than 10,800 frs. the whole amount is exempted, and if it ranges between 10,800 frs. and 43,200 frs. the tax will be levied only on one-third.

Relief for children is calculated as a percentage of the income with a maximum limit. The exemption for one child is 15% of the income if that does not exceed 5,000 frs., for two children 30%, for three 75% and for four and more 100% with a maximum of 15,000 frs. for each child after the second.<sup>1</sup> In the meantime if the individual participates effectively in the exercise of a business under the schedule of commercial and industrial profits he is entitled to 150,000 frs allowance.<sup>2</sup>

b. Insurance expenses:

The deduction of the expenses paid by the individual to secure his future maintenance or his heirs' financial position are a matter of dispute between the writers in taxation. One may consider such expenses as disbursement of income and another may look at them as the discounted value of uncertain future receipts.<sup>3</sup> These views influenced the attitude towards insurance annuities in the different tax legislations. In this case the British legislator seems to be more liberal than those in Egypt and France. He allows for deduction on premiums, on policies

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1. The Sunday Times' representative in Paris reported on March 2nd 1952 on the French Taxation system and referred to deductions through a system of family coefficients. This seems to be different than the system explained in Memento Fiscal p.41 which reported taxation changes up till March 15th, 1951, and the 'Inventaire de la Situation Financiere' of 1951.

2. Memento Fiscal p.16

3. Fisher, op. cit. pp.18-9

for life, endowment with capital sum at death, deferred annuity for widows or children, accident or sickness policies which include death risks and contributions to the new National Insurance Scheme. It is stipulated that these allowed deductions should be limited in proportion to income and to the capital sum assured. Not more than one-sixth of the total income of the year of assessment is allowed in the aggregate, and also the allowance for any premium must not exceed 7% of the capital sum assured. Some premiums are not allowed, such as those on policies which do not provide for a capital sum at death, on lives other than those of the taxpayer or his wife, policies which do not include a life risk and sickness or accident policies, unless they can cover death risk. It seems that this stipulation is a precaution against attempts at evasion.

In Egypt and France the exemption of insurance premiums or pension reserves is applied to wages, salaries and emoluments. The amount is 7,5% of the earnings in Egypt,<sup>1</sup> and between 3% and 5%, in France.<sup>2</sup> These arbitrary percentages follow those applied by the State in dealing with its employees. The General Income Tax in Egypt allows also for deduction on all premiums for life insurance or pension without any limit.<sup>3</sup> This provision, while it universalises the deductions of premiums to all income taxpayers, leaves the door wide open for evasion and gives an undue privilege to a certain class of the people. The French system, on the other hand, limits the exemption from the equivalent

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1. Art. 62 Law No.14 of 1939

2. Memento, op. cit. pp.40 and 42

3. Art. 7, Law No. 99 of 1949



tax (surtaxe progressive) to the amount paid for social insurance.<sup>1</sup>

c. Professional expenses:

In addition to these deductions the three income tax systems allow for other expenditure, which is exclusively for the purpose of earning income and not of a capital nature such as lighting, heating, telephone, repairs to business premises and subscriptions to hospitals and first aid societies from which the business staff benefits.

In Egypt the range allowed for deduction was widened as a result of the pressure of the interested classes. Since 1948 all grants and subscriptions paid to social or religious institutions recognised by the Government are allowed for deduction from the gross profit up to a limit of 3% of the profits. Most of these expenses are not an 'income-cost' and the Taxation Department fought unsuccessfully against this amendment of the law. The same procedure was taken in framing the tax on General Income in 1949 and all grants to charities and the like paid by the individual to the State or other benevolent institutions is deducted up to a maximum of 3% of the annual income of the individual. It is argued that the tax should only strike the net amount at the disposal of the individual and that these grants curtail his purchasing power and should thus be deducted. But such grants have no relation to the earning of income; they are disbursement of that income. It is customary in Egypt to find some people distributing a considerable amount on social schemes for the sake of getting a State honour.

The French have a special scheme to deduct professional expenses in addition to the general one followed by other tax systems. These

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1. Art 39, Law No.14 of 1939 as amended by Law No.138 of 1948.



professional expenses are varied in amount according to the job practiced; dramatic artists and musicians, for instance are allowed 20%, journalists 30%, commercial travellers 30%, bus drivers and conductors 20% and mannequins 10% and so on.<sup>1</sup>

d. Taxes paid on schedular incomes:

There is a problem with regard to the duality of income tax in Egypt and France in the imposition of taxes on the schedules of income and then on the total income. According to the two systems, the 'direct' taxes paid on the different schedules are deductible from the gross income charged for general income tax.<sup>2</sup> This practice increases the rate of the tax more than that given in the scale of general income tax which should be the governing factor. If we take the simple case of an individual, whose income is realised from profits, we find that he has to pay £12,000 as profits tax and £28,570 on the net income or an aggregate of £40,070 i.e. 40%. But if he has to pay only the tax on the general income the charge would have been £33,370 i.e. 33% (1950 rates).

The French writers are very liberal in their viewpoint in stating that taxes payable on general income in one year must be deducted from the income received in that year, and that, otherwise, there will be a case of double taxation.<sup>3</sup> To this charge Plehn furnished the best answer stating that "income tax laws are logical in not allowing the income tax itself as a deduction. This is primarily because it is a

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1. Memento Fiscal, p.43

2. Ibid p.60 and Law 99 of 1949

3. Allix, E & Lecercle, M. Impôt sur le Revenu Tom.Ie, p.208

personal tax and not so easily confused with business taxes".<sup>1</sup>

e. Interest on personal loans:

The interest on personal loans is another bone of contention in income taxation. It seems that the British legislator holds rigidly to the principle that expenditure can only be deductible if it is for the purpose of earning income and thus interest on personal credits has no relation to business activity and is not deductible. In Egypt and France this restriction is not applied and the individual may debit his taxable income account by the total of the interest on his personal loans.

f. The carrying forward of the personal expenses:

If we agree on treating human beings as other physical factors of production, in need of a minimum of subsistence to keep them intact,<sup>2</sup> we have to accept the deduction of sick expenses and apply the carrying forward of any part not being enjoyed from the subsistence allowance because of unemployment or when the income fails to reach to minimum level. This point does not arise in Britain which provides aid for the unemployed. But in Egypt, and in some cases in France, an unemployed person is left to find a way out. He may fall into debt or become destitute. I think it will be just as beneficial for the community to allow the individual to carry forward the part of the minimum exemption which he was unable to use.

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1. Plehn, C.C: Introduction to Public Finance, p.244.

2. According to Laufenburger, op. cit. p.189. "On peut appliquer la notion de l'amortissement à la personnalité humaine et dire que le minimum d'existence lui permet de lutter contre l'usure prématurée de ses forces, comme l'amortissement proprement dit sert au renouvellement de la machine".

ii. Allowed deductions in computing business profits.

The problem of allowed deductions from business profits is very delicate, due to their repercussion in the development and progress of business activity and their effect on the incentive to invest and produce. The highly progressive rate of taxation makes the computation of profit in particular periods a matter of a highest importance. The distinction should be made clear between expenditure which is incurred in the course and as part of the process for realising the profit, and the expenses which are merely a disbursement of these profits. The conception of income should also be present, in our mind, in order that deduction would be logical, and, if capital increment is accepted as income, capital decrement should also be deducted.

In the process of production the instruments used may be impaired by depletion, depreciation or obsolescence, and allowance is necessary to set against the deterioration which results from such conditions.

a. Depletion.

The term 'depletion' is used to describe the process of using up the factor of production. The taxation practice allows such depletion which is due to the physical exhaustion of the factor but not due to abnormal circumstances, such as war or earthquake. The latter sort of depletion is treated as capital loss, because it is not relevant to current net income.<sup>1</sup>

Until recently Britain provided no allowance whatsoever for the depletion of wasting assets, such as minerals, oil, gas, timber and other

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1. Pigou, Econ. Journal, op. cit. p.240

natural deposits. It was held that allowance for depletion should not be granted "in respect of a right to the income derived from any asset".<sup>1</sup> This principle was criticised especially in relation to British mining concerns operating in foreign countries, as it put them in an unfavourable position compared with similar foreign concerns which were allowed such an allowance. The Royal Commission on the Income Tax of 1920, agreed that "when the right of future profits has been purchased from a vendor who is entirely outside the scope of British Income Tax...an allowance should be made for the amortisation of the capital sunk in the purchase".<sup>2</sup> This principle was adopted only in 1949, following a recommendation by the Departmental Committee on Taxation and Overseas Minerals. The Committee stated that "the grant of a depletion allowance might enable the concern to give a better return to its shareholders or might enable it to create additional reserves for development and extension".<sup>3</sup> Thus they recommend the grant of depletion allowance to British concerns running overseas mineral deposits in respect of capital expenditure, based on what was laid out on the acquisition of the mineral rights by the first British resident, or company controlled in Britain or on the capital cost of the mineral rights to the person entitled to the allowance.<sup>4</sup>

There seems no reason why this practice should not be extended to all capital expended in the acquisition of any mineral right.

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1. Report on Taxation of Trade Profits, p.77
  2. Quoted by Ibid, pp.77-8
  3. Report of the Departmental Committee on Taxation and Overseas Minerals  
Cmd. 7728 p.4
  4. Ibid p.11



Depriving the mining concerns from depletion, allowance could only be justified if no capital were spent on the mineral right. If it was feared that providing such an allowance might result in the escape of the vendor from income tax, a special tax might be levied on him in spite of the fact that such a right is considered an increment of value.

The assumption that mineral rights are not considered depreciable because the vendor might escape paying the tax in one way or another, does not arise in Egypt. According to the Egyptian law of ownership, the individual is entitled to ownership of the surface of the land only, anything underneath the surface, such as mines or minerals, is exclusively owned by the State which can dispose of it through a concession of limited duration after the approval of Parliament. This reservation is a legacy of the old rules, which allowed the usufruct of land but not its ownership for the individual. These rules were broken down in the second part of the last century.

In principle the Egyptian and French practice accepts the deduction of reserves necessary for depletion of the capital. This is in conformity with their concept of income which includes increment and decrement of capital in the profit and loss account.

In the same category is the reserve which is set aside to pay for the establishments of a concern, which might be asked to surrender them without compensation on the expiry of its concession. These establishments are clearly of a wasting nature but still the British practice does not



allow any deduction in this case,<sup>1</sup> unlike the Egyptian and French practice. The Egyptian law makes it clear that the tax does not apply "to companies holding a concession from the Government or from other public authorities, when they prove that the redemption of the capital in whole or in part ... is justified by the loss of the company's assets wholly or partly, either through the progressive wear and tear of the said assets, or by reason of the obligation of the company to hand over these assets to the authority which granted the concession."<sup>2</sup>

b. Depreciation.

This term is used to describe the loss of value of the asset due to physical wear and tear, and it does not refer to any diminution in the market value of the asset. The allowance for wear and tear is in the aggregate equal to the cost of the depreciated asset.

In spite of the fact that depreciation is an important item in computing business profit, it was not legally accepted in the British Income Tax practice until 1878. The tax Commissioners used to allow deduction for wear and tear before that time in certain cases, but without any legal authorisation.<sup>3</sup> Since 1878 depreciation allowance has been given to traders and was extended in 1925 to include professionals.<sup>4</sup>

Almost all Income Tax laws approve the deduction of wear and tear allowance from gross profit without any reservation so long as the plant

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1. Report on the Taxation of Trade Profits p.79

2. Art. 2, Law No. 14 of 1939

3. Vasiliu, op. cit. p.67

4. Spaulding, op. cit. p.188

or machinery was in use during the period of production. The British system does not give "a depreciation allowance as an expense in computing the profits of a period unless the plant had been in use for the whole or at least a substantial part of that period".<sup>1</sup> After 1949 the rate of depreciation was allowed to increase "where a particular machine is worked overtime".<sup>2</sup> The depreciation rate in Egypt and France is variable and fluctuates according to the running time of the machine compared with normal working.<sup>3</sup>

The difference between the two practices is a result of the outlook towards the allowance. In Britain, a claim for depreciation allowance should be made separately, and when approved it can be deducted from the gross assessment. The Egyptian and French practices follow the accounting logic and deduct the depreciation in computing the amount of profits on which the assessment is made.<sup>4</sup> The difference might look simple, but it goes beyond historical or practical considerations. According to the British practice the concern has the right to claim or not to claim depreciation allowances and it might be better for it, sometimes, not to make any claim, if that would mean a loss whose recovery might be doubtful, in the limited time of carrying over. The British

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1. Report on the Taxation of Trade Profits p. 87

2. Ibid, p. 90

3. Egyptian Income Tax Regulations.

4. Art. 39 of the Law 14 of 1939 reads as follows "The net profit liable to tax shall be determined on the basis of the result of the operations ... after deduction of all charges and especially ... actual depreciation effected in the sphere of what is habitually practised in accordance with the usages and with the nature of every industry, trade or work".

system has another effect in that "the profits of some periods may be assessed two or more times and the profits of other periods may not come into assessment at all".<sup>1</sup>

It is suggested that the logic in the Egyptian and French practice should not deprive the concerns of the possibility of shifting the depreciation allowance from the bad year to the profitable one.<sup>2</sup>

b. Depreciation of intangible assets:

There are also intangible assets which raise the problem of allowance for their depreciation such as patents, copyrights and goodwill. These items do not wear in the same way as the tangible assets but their value may gradually diminish.

The British legislator is hesitant to allow any deduction in respect of deterioration or diminution of capital assets employed in the business. "No clear principle is deducible from the treatment of wasting assets under existing law",<sup>3</sup> but in fact allowance is given for replacement of fixed assets or stocks. But great progress has been made since the end of the war, when the economic problems necessitated a reconsideration of the depreciation principle. In 1945, the taxpayer is entitled to write off the cost price of a patent by instalments over a number of years. The acceptance of this principle increased the concept of income as 'the capital sum received for the sale of patent right', which became liable to the tax. The Committee on the Taxation of

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1. Report on the Taxation of Trade Profits p.87

2. Al Rifaei op. cit. p. 342

3. Report op. cit. p. 63 and Report of the Income Tax Codification Com. p. 84

Trading Profits accepted as a guiding principle the view that relief should be given to different assets and expenditure which is at present treated as capital expenditure.<sup>1</sup> But they stick to the principle that there should be decay or exhaustion through use before any allowance is given.

In the case of goodwill, there is no indication that an initial loss is incurred, or that the goodwill is used up or consumed wholly or partly in the course of carrying on the business, and thus any allowance for its depreciation could not be granted.<sup>2</sup> Edwards came to the same conclusion from a different angle. He stated that goodwill "is merely the difference between the value of the business at a moment of time" and cannot be written up "even if it is clear beyond all reasonable doubt that the value of the business has risen".<sup>3</sup>

The Egyptian and French legislators based depreciation allowances on their definition of income. It is quite acceptable then that capital gains and losses are included in the profit and loss account of any concern. Accordingly, patents, copyrights and goodwill are deductible elements.<sup>4</sup>

#### c. Obsolescence:

The term obsolescence is used to mean the losses which are sustained when the value of the asset deteriorates, due to changing conditions of the business in which it is used. The value of any factor is mostly derived from the value of its products. Thus any change in the fashion,

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1. Report on Taxation of Trading Profits p. 64

2. Ibid p. 65

3. Edwards, R.S: Lectures on the Nature and Measurement of Income (1938) VIII p. 4

4. Al Rifaei, ip. cit. pp. 343-4

in the pattern of industry or in the movement of population, would affect the demand on producers' goods and their value might go down, if their services were no longer desired. "The price of a piece of machinery" stated Edwards, "is the present value of the flow of services expected to be derived from the rights to its possession".<sup>1</sup>

Annual deduction for obsolescence is not allowed in any of the Egyptian or the French systems. In Britain, in addition to the allowances granted for the rationalisation of industry by F.A. 1935, other initial allowances were granted by F.A. 1945, for machinery and plant, in order to facilitate any replacement because of obsolescence. When the machinery or plant is replaced or scrapped a balancing account is made and the profits and loss accounts is to be debited or credited by the amount due.

The Egyptian practice is less liberal in this course; it only allows any capital loss, if the given depreciation plus the price of scrap is not enough to pay for the prime cost of plant or machinery when sold. Any replacement which is listed as a new asset is entitled to deductions in the normal way.

During the war prices of capital goods were excessively high, and it was considered just to allow business concerns a special reserve to amortize the probable depreciation in the value of stocks purchased and the installations established during the war.<sup>2</sup> If any machine was brought after January 1st, 1940, two accounts should be opened for it:

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1. Edwards, op. cit. III, p. 1.

2. Art. 7, Law No. 60 of 1941



in the first, the price of the machine at the pre-war price and in the second, the difference between the estimated and the real price. The first account would bear the normal depreciation rate and the second should be written off by the termination of the E.P.T. The amounts deducted in accordance with stocks, were not to exceed 25% of the excess profits of the year and in accordance with installations were not to exceed 50%, a maximum of 60% of excess profits would be allowed for the aggregate reserves. This special treatment came to an end in 1950 when the E.P.T. was abolished.

The French practice up to 1938 was similar to that adopted in Egypt, but the war made it impossible to leave it without alteration. According to the existing scheme, the cost of an existing plant is to be multiplied by an index calculated from statistical figures of the wholesale of 87 industrial products.<sup>1</sup> The coefficient used is 1 for 1939, 1.25, 1.35, 1.5 and 2.0 for the following years.<sup>2</sup> In favour of the corporations which establish dwellings for their workers, they are allowed an exceptional amortisement of 40% in the first year and then the residue to be amortized in 50% with an annual rate of 1.20%.<sup>3</sup>

The problem of computing the profit after allowing for the higher cost of replacing fixed assets and stocks at this time of inflation is causing worldwide controversy. It is alleged that the rigidity of the system of depreciation is responsible for the intensification of the trade cycle. During inflation the profits are overvalued and depreciations

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1. Formery, op. cit. p. 201

2. Ibid pp. 180-1

3. Memento, op. cit. p. 18

under-valued; the contrary occurs in time of deflation. The problem of depreciation is the result of the accounting practice which followed the classical hypothesis of a static state. But in the dynamic state changes are continuous and the value of the assets fluctuate rapidly. The Tucker Committee, after discussing the problem of depreciation and replacement and the suggestion by business-men of a "revalorisation" scheme, or a special replacement allowance, objected to them both, because they do not satisfy the test of being equitable between different classes of business, or practicable in administration.<sup>1</sup> If there is a real difficulty in accepting either proposal, the rates of depreciation should be increased; in other words, the time of amortization should be reduced as much as possible. The Egyptian practice of giving a special reserve for depreciation when E.P.T. was applied, or the French system, might give a solution to the problem in Britain. Lacey proposes "that an appropriate retrospective adjustment might be (suitable) to create a reserve against current stock values".<sup>2</sup>

d. Other deductions from gross income:

To ascertain 'net' income, other deductions, in addition to those affecting the invested capital, should be taken into consideration. Any allowed deduction should be exclusively laid out or expended for the purposes of the trade. In this category there are the losses sustained during the business, bad debts, taxes, advertising, subscriptions, bonuses and pensions to the employees, etc.

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1. Tucker, Report p. 41

2. Lacey, K: Economic Journal Vol. 61, 1951, pp. 756-776

(1) Losses.

Loss by fire, theft and burglary which are not covered by insurance could be debited to the profit and loss account. A person or a corporation which has incurred a loss in a trade may carry forward the loss, and set it against the profits, in the following years of assessment. The Egyptian system limits the period of carrying forward to three successive years compared with six in Britain and five in France.<sup>1</sup> A special provision was made in Britain during the war through which the war years i.e. 1939-40 to 1945-6 were ignored in computing the six-year period.

It seems that the time limit for carrying forward the losses is of an historic nature, and is based on the assumption that an indefinite time would result in a strain on the tax collectors. But allowance against wear and tear can be carried as long as fifty years<sup>2</sup> and even indefinitely, and there is no reason why business losses should not be carried forward in the same manner.<sup>3</sup>

The application of this proposal would lessen risk-taking to a large extent and would, most probably, encourage long term investments where some years have to pass before any profit can be realised. In the meantime as the proposal might lead to tax evasion through the incorporation of losing concerns with those incurring profits, precautions should be taken against such a possibility.

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1. Al Rifaei, op. cit. p. 346, Law No.14 of 1939 Art. 57 and Report of Taxation on Trade Profits, p. 28
  2. The smallest rate of depreciation in Egypt is 2% for buildings
  3. Report of Taxation on Trade Profits, p. 28

The British Income Tax law enables the taxpayer to set a business loss against other income for the same year but does not allow setting the loss against non-business income in any other year.<sup>1</sup> The Egyptian and French General Income Taxes allow the loss resulting only from the closing down of the business or its liquidation to be set against income, incurred from any other source, the losses of the three or the five years preceding to the closure.<sup>2</sup> It does not seem that the two laws allow the business losses of one year to be carried forward and set against non-business profits in any other year.

The Tucker Committee recommends that the system of carrying forward should be allowed for one year only, as it is feared that any extension would open the door to tax evasion.

## (2) Bad debts.

The different tax systems do not allow any appropriation to reserves for doubtful debts but accept the deduction of bad debts when it is proved to the tax Commissioners that they were considered lost. If anything is recovered from the written-off debts, the receipt should be credited to the profit and loss account.

## (3) Taxes:

Business taxes and local rates are deductible from the tax on Com. and Ind. Profits in Egypt and France. British legislation allows also the Profits tax to be deducted from the Income Tax.

The deduction of the foreign income tax is allowed in Britain

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1. Ibid p., 29

2. Art. 7, Law 99 of 1949 and Memento p. 61



except where relief is claimed under reciprocal agreement. This is taken to lighten the burden on the concerns which are taxed in Britain as well as abroad. But there is a problem arising from the claim of more than one country to a priority in taxing the profits of a concern. In the case of the Suez Canal Co. the concern deducted the Income Tax and the N.D.C. paid in Britain from its taxable profits in Egypt. The company is considered as resident in Britain because its board of directors meets there, but its enterprise is carried on in Egypt. The Egyptian court refused to recognise the deduction and compelled the company to pay the Egyptian schedular tax on all the profits realised in Egypt.<sup>1</sup> International agreement should be concluded to relieve the corporations operating in more than one country from double taxation.

#### (4) Subscriptions and donations.

Any subscription or donation which is given purely to maintain the business or to a benevolent institution from which the business staff benefits is deducted under any system. But if the charities and donations have no connection with the business, they are not deductible except in Egypt where they are allowed to the maximum of 3% of the net profit of the concern. This latter practice deprives the Government of large amounts which should be considered as disbursement of profit and not an income-cost. The necessary amount for 'Holiday with Pay' schemes which are applied in Britain and a reserve for employers' bonuses, limited to two-months pay in Egypt, are allowed as a deduction for tax purposes.<sup>2</sup>

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1. Al Rifaei pp. 338-40

2. The Report on the Taxation of Trading Profits, p. 62 and Art. 39 of the law No. 14 of 1939



To hasten economic progress after the war, Britain allowed as deductible all sums expended, not of a capital nature, on scientific research undertaken by the concern or on its behalf through a university or otherwise, if the expenditure be carried in instalments of one-fifth every year.<sup>1</sup>

On the whole, the deductible amounts from gross profits in order to reach the 'net' taxable part depend mostly on the custom or practice in the industry and trade as well as on other practical, economic and financial considerations.

The following table shows the deductions allowed from the 'net true' income in Britain. As no such information is available for Egypt or France, no comparison can be made.

£ Mn.

Net True Income for 1949-50	9,430.1
Income below the exemption limit	33.5
Charities, Colleges, Hospitals, etc.	50.0
(Personal allowances and deductions	
(Allowances for children, dependent,	
etc.	5,140.0
Life assurance	125.0
	<u>5,348.5</u>
<u>Taxable Income</u>	
At one-third	694.0
At two-thirds	971.0
At Standard rate	2,416.6
	<u>1,482.9</u>
Tax Chargeable	1,482.9
Double Taxation Relief	36.0
	<u>1,446.9</u>
Net Produce of the Tax	1,446.9

Source: Report of the Inland Revenue 1951 Cmd. 8436 p.42.

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1. Draft, Income Tax Consolidation Bill pp.250-1.

CHAPTER VDIVERSION FROM THE UNIVERSALITY PRINCIPLE.  
EXEMPT INCOME AND THE PROBLEM OF DOUBLE TAXATION.

In a general and absolute manner the principle that all citizens are equal before the law in matters of taxation, underlies the political constitutions of modern States. This universality principle leads to the supposition that no citizen receiving an income may escape the liability towards the State, and that those who enjoy a given income must receive the same fiscal treatment.<sup>1</sup> Such a principle is constitutionally accepted as a safeguard against the old privileges when the dominant classes in society were exempted from taxation while the burden was borne by the masses. But this equality of all citizens before the law of taxation could not be held in a rigidly objective sense, and complexities in the socio-economic framework resulted in an intentional and non-intentional diversion from that canon. In the existing tax laws we find that some incomes are exempt while at the same time others are taxed more than once. The following is an attempt to analyse these two contradictory tendencies.

I. Income Exempt:

Before discussing income exempt in its different aspects, there is the logical exemption given to the State and its institutions. It might be agreed that there is no need of provision of exempting the State from taxation because taxes are levied for its own functions, and

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1. De Marco, op. cit. p. 166

it would be illogical if it had to tax itself. In spite of that, provisions had to be made to counteract the taxes which strike wealth objectively without regard to the beneficiary of the income. It is a constitutional principle that no exemption whatsoever shall be given except in the cases provided for by law. In the three legislations under comparison exemption from taxation covers:- The returns of State departments, the Mint, the Arsenal, the State Press, the Stock dividends belonging to the State and the State domain. Laufenburger holds the view that the reason for any exemption of a State department should be the unproductivity of a revenue or income. This led him to suggest the imposition of taxation on public domain.<sup>1</sup> The French legislation extends exemption to the industries monopolised by the State, such as alcohol and tobacco, where no competition with private enterprise arises.<sup>2</sup>

The transference of any State property to an individual makes it subject to the tax. But the Mixed Courts in Egypt held the view that the exemption should be maintained, if the transference was temporary, on types of concession, on the termination of which the property was to be restored to the State.<sup>3</sup>

In addition to the exemptions provided for State departments and their transactions and those given for minimum of subsistence and family upkeep which were previously discussed, other exemptions are allowed for political, social and economic reasons. These exemptions

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1. Laufenburger, op. cit. pp. 171-172

2. Ibid, p. 112

3. Al Rifaei, op. cit. pp. 195-196

may be permanent or occasional and may be absolute or limited, in accordance with the circumstances which called for them.

a. Exemption for political reasons:

In the old days exemption from taxation was part of the political privilege enjoyed by the secular and ecclesiastical classes. The change in the politico-social order of society terminated that privilege; but the existing parliamentary régime attempted to create new ones in favour of the powerful parties and to attract votes in the election.<sup>1</sup> The Government when exempting a certain income and granting a certain allowance, never admits that it has done so for any reason but the welfare of the masses and the prosperity of the nation.

(i) Exemptions for the Sovereign:

Passing from the point in the meantime, we find a remnant of the old political privilege in the exemption of the Royal Family from taxation. Up till 1689 in Britain and 1878 in Egypt, there was no separation of the income of the Sovereign and that of the Government. The products of the Kings' estates and the contribution of his vassals used to form the source of public expenditure. The Revolution in Britain and the financial crisis in Egypt resulted in the Sovereign relinquishing most of his lands and revenues in return for regular votes of funds for his personal and his household requirements.<sup>2</sup>

From the constitutional point of view, the King enjoys large

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1. Laufenburger, op. cit. p. 169

2. Ogg, F.A.L.; English Government and Politics, p. 103 and Henein, G: Land and Taxation in Egypt (in Arabic) p. 46

personal immunities and privileges. "He cannot be called to account for his private conduct in any court of law by any legal process".<sup>1</sup> He is not bound by any Act of Parliament unless by specific mention or by direct inference. Accordingly the Crown in its official capacity, is not liable to Income Tax. By the Crown Private Estates Act of 1862, the private estates of the King are, however, subject to taxation. Similarly any private trading projects realised by the King are subject to taxation.<sup>2</sup> In Egypt the Financial Crisis of the 1870's which was of international importance and resulted in the Khedive's surrender of his estates, necessitated the imposition of the tax on all lands without exception.<sup>3</sup> Now the King owns land and rents dwellings and he pays tax on them like any other individual. In the same manner he pays the tax on the return of immovable property which is of an impersonal character. When the Schedular Income Taxes were imposed, it was debated whether the Royal allotment was taxable or not. The general opinion was in favour of exempting it simply because the allotments were fixed by approval of Parliament on the King's accession to the throne, and, when once approved, could not be altered without a constitutional change.

The problem which has yet to be solved is the application of the general income tax to the income of the Sovereign realised from all

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1. Ogg: Ibid, p. 102 and Art. 33 of the Egyptian Constitution
  2. Boiting, J.G.G: The Inequalities of English Income Tax, M.Sc.Thesis, London, 1944. This conclusion is different from that which Ogg stated in p. 103 that the Monarch in Britain is exempt from taxation of both his income and his property.
  3. The land tax as was stated before was assigned as a guarantee for the debt charges.



sources other than his personal allotment. The writer's view is that the King's income should be made liable to the tax with its progressive rate in the same manner as is any other individual's. This could be justified by the understanding that the products of the King's estates compete in the market with those of other individuals, and that the Civil List allotment is enough for the necessary functions of the King.

(ii) Exemptions for diplomatic representatives:

Certain immunities from income tax are given to diplomatic representatives of foreign countries. These immunities are based on an extra-territorial jurisdiction enjoyed by these representatives and on reciprocal treatment.<sup>1</sup> But this immunity is not absolute and differs between one country and another.

In Britain the tax is charged under Sch. A. "in respect of any house or tenement occupied by the accredited Minister of any foreign State".<sup>2</sup> In Egypt Embassies and Consular buildings are exempted if the property is owned by a foreign State.<sup>3</sup> The French legislator is more logical in allowing the exemption on a reciprocal basis.<sup>4</sup> With reference to the emoluments which the foreign representatives receive from their own Governments, it is obvious that the country of residence does not apply the tax to them as they are already subject to their own country's tax. But the case is different in relation to the income received from investments within or without the country of

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1. Laufenburger, op. cit. p. 170

2. Draft. Income Tax Consolidation Bill p. 65

3. Art. 2. House Tax Law of 1884

4. Formery, op. cit. p. 110

residence. According to the British system, no tax is charged "in respect of the stock or dividends of any accredited Minister of any foreign State" resident in the country.<sup>1</sup> In Egypt and France the Schedular Income Taxes are largely of a non-personal character and are applied to the return without any reference to the beneficiary.

In addition to these exemptions there are others which concern Egypt because of its political position. Up till 1937 'foreigners' were privileged by the Capitulations and exempted from all direct taxes. No direct tax could be imposed on them without the approval of their Governments and the Court of Appeal had the right to judge the constitutional validity of any law as far as 'foreigners' were concerned. This practice which weighed the scale heavily against Egyptians was abolished as we have seen in 1937. Besides, there were other privileges and immunities given to the British Forces in Egypt according to the 1936 Anglo-Egyptian Treaty.<sup>2</sup> In a convention attached to that Treaty British Camps and members of the Services were immune from all taxation, other than the municipal rates for services enjoyed. But no exemption from taxation was granted to the members of the Forces who were owners of real property, nor from the taxation on commercial and industrial profits. The members of the Military Missions, as well as U.N.R.R.A. were also accorded semi-diplomatic status, but as individuals; when dealing in business transactions, they were subject to the tax. The N.A.A.F.I. and other Clubs which belong to the Forces were also exempt

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1. Consolidation Bill, p. 69.

2. Art. 9 of the Treaty.

from taxation.

b. Exemption of charitable and educational institutions:

Long before the modern State took responsibility for the welfare of the public, this function was carried on by different charitable bodies. The take-over was incomplete and some of these bodies had to remain in order to supply the public with their traditional service. The charitable institutions do not work for profit but to alleviate the burdens of the masses, whether material or moral.

The exemption of charitable bodies, like any other exemption, was a matter of controversy. Some taxpayers hold the view that every exemption throws an additional burden upon the rest of the community. Moreover, it is argued that in functioning, these bodies are hindering the State from playing its full rôle in the welfare sphere. To the individualist any attempt to repeal or to curtail the relief enjoyed by charities means <sup>an</sup> increase of the responsibility of the State;<sup>1</sup> in other words, an increase in the rate of taxation and in the directional power of the State. It is also feared that taxing charitable bodies will result in the termination of this humanitarian activity which links individuals together and lessens the material friction between classes. Income Tax laws adhere to the latter view, but they differ in their definition of charitable purposes.

The British law exempts charitable bodies or trustees "for charitable purposes in respect of their rents, dividends and interest, in so far as they are applied to charitable purposes".<sup>2</sup> The definition

1. See Report of the Royal Commission on the Income Tax, Cmd. 615, p.68 (attempts made to curtail the allowances by Gladstone in 1863 have failed).

2. Ibid, p.67 ✓

of the last phrase dates back to Elizabethan times and embodies: the relief of poverty, the advancement of education and science, the advancement of religion and practically all other purposes beneficial to society. The House of Lords emphasised that definition in 1891.<sup>1</sup> The Royal Commission on the Income Tax of 1920 criticised this wide definition and called for a specific re-definition by Parliament.<sup>2</sup> In the F.A. 1922, "Charity" was limited to any "body of persons or trust established for charitable purposes only",<sup>3</sup> but the definition of charitable purposes did not change.

The British system is very generous in granting exemptions to charitable bodies. It exempts land, tenements and heritages owned and occupied by charities as well as profits of a trade carried on by any charity if such profits are applied solely to the purposes of the charity, and also rents, interest, dividends and annual payments belonging to them.<sup>4</sup> There is a proviso that, in all cases of property owned by a "charity", if any portion is in the use and enjoyment of any individual it shall be returned in assessment if his total income exceeds the limit of personal exemption.

According to the former rule, the following institutions are free of tax: hospitals, almshouses, public schools, colleges, universities, research institutions, scientific associations and places of worship. This category includes also the British Museum, the agricultural societies and the local authority sewers.

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1. Ibid, pp. 67-68

2. Ibid, p.68

3. Report of the Codification Committee, op. cit. p.227

4. Consolidation Bill, pp.348-349



The exemption given to charitable societies and for charitable functions is restricted in Egypt and France. Under the Egyptian law the land which is destined only for the Benefit of the destitute and mosques, churches and other buildings specified for the poor are exempt from taxation. But the lands and buildings owned by any religious or charitable institutions are subject to the tax.<sup>1</sup> This rule is nearly similar to that applied in France,<sup>2</sup> where, it seems, these restrictions are related to historical conditions. In 1813 the Viceroy of Egypt, Mohamed Ali seized all the land which was redistributed after being surveyed and assessed for taxation. The privileges of religious and charitable institutions were abolished and only those lands which were destined strictly for the benefit of the poor were saved from the axe. As to the land tax, it was revised when Egypt was passing through a severe economic and political crisis and no room could be spared for exemptions except those which have been previously described. In France, the Revolution deprived the Church of most of its property and opposed all kinds of privileges whatever their form. Since then people are suspicious of any exemption from taxation.

In the case of the Schedular Income Taxes, no allowance is given for charitable institutions in the case of the impersonal tax on the return of moveable property, but in the personal commercial and industrial profits tax, exemption is granted on their receipts from donations, subscriptions and the like. If these institutions run any lucrative business they are bound to pay the tax even if the profits are

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1. Art. 7, Law No.113 of 1939 (Land Tax) and Art.2, Decree of 1884 (House Tax)

2. Formery, op. cit. p.110



intended to pay for their functions according to Egyptian and French practice.<sup>1</sup>

When income tax was first imposed in 1939 in Egypt, the legislator laid special emphasis upon exempting all the educational institutes: but in 1941 this privilege was limited to those established by charitable or religious associations. This action was justified as a measure against tax evasion, because it was found that some private schools or colleges for shorthand, typewriting, linguistics, music and dancing realised a clear profit and should thus be treated like any other commercial concern. But this argument is not enough because the word 'educational institute' can be clearly defined. Taxing private schools may hamper their activities at a time when they are helping to educate the people in a country a considerable number of whose population is illiterate. Most of these schools receive annual subsidies from the State and according to the definition of income by the Taxation Department they have to credit their balance sheet with that sum, a principle which apparently contradicts the educational policy of the Government.<sup>2</sup>

c. Exemption for social expediency:

The personal minimum allowance to keep the human body intact does not usually follow the poverty line. It fluctuates according to political and economic conditions, but on the whole, in a progressive state such as Britain, the margin is kept higher than the subsistence level for social expediency reasons.

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1. Egyptian Tax Regulations and Laufenburger, op. cit. p.172

2. The continuous criticism to the Government, attitude bore fruit and by law passed in October 1951, educational institutions are re-exempted.

The great depression of 1930 had the powerful effect of raising to a higher level generally the standard rate of exemption in order to increase the propensity to consume.<sup>1</sup> France follows the same policy and the minimum income exempted from taxation is comparatively higher than the subsistence level and fluctuates according to the socio-economic changes. In Egypt, the average rate of taxation is low and thus little importance is given to personal exemption. The principle is not always respected. Some people may get an exemption exceeding the minimum of subsistence, as in the case of earnings from commercial and industrial transactions which is £100 for a single person; others enjoy an exemption below the poverty line, that is £14.3 of the land rental value; and the section receiving interest from moveable property are not allowed any tax exemption. In addition to this inequality of help in raising social standards, the tax exemptions given in Egypt are static and do not follow any change in prices or the level of subsistence.

The benevolent bearing on the income tax structure is felt in providing special relief for old people. In Britain, if the individual or his wife have reached the age of 65 and his total income does not exceed £500 per annum, he is entitled to a deduction equal to one-fifth of that income; that means he has to pay taxation only on four-fifths of his income. In Egypt exemption for old age is only allowed to the professional classes, who pay no tax on their earnings when they reach the age of 60 years. This exemption is criticised as creating an unreasonable privilege which is not allowed to any other section of the

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1. Taylor, P.E: The Economics of Public Finance, pp.460 and 604

taxpayers. Moreover, there is no proof that the earnings of professional people are so drastically reduced after reaching the age of 60 as to justify such a sweeping exemption.

The taxation systems did not fail to recognise the importance of educating children on whom the responsibilities of the future rest. This children's allowance is extended after the normal school leaving age if they continue full-time studies at any university, college, school or other educational establishment.<sup>1</sup> Unlike the British practice, the Egyptian law limits the age of the child in this case to 25 years and requires that he should be attached to a higher school or university and not otherwise.<sup>2</sup> Moreover, the British law states clearly that no relief shall be allowed if the child is entitled to an income of his own exceeding the limit of allowance (£60). Scholarships, bursaries and other educational endowments are not considered income in this respect following the strict definition of income used for taxation purposes in Britain.<sup>3</sup> The Egyptian legislator misses this point and grants educational allowance regardless of the child's financial position, thus leaving the door open for evasion.

Other exemptions from taxation are provided in Britain for income received in respect of disabilities incurred during service in the Crown forces, and for retired pay of disabled officers granted on account of medical unfitness attributed to or aggravated by naval, military or air force service.<sup>4</sup> Similarly, there is exempted from taxation all

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1. Consolidation Bill, p. 138

2. Art 10, Law No. 99 of 1949

3. Consolidation Bill, p. 139

4. Ibid, p. 287 and Memento Fiscal, p. 42

compensation paid for war injuries and allowances given to widows or children of the forces.<sup>1</sup> The Egyptian law does not make any reference to exemption for such consequences of national service.

The income tax laws in Britain and France do not reckon in computing income, the unemployment benefit, sickness and maternity aid and death grants which are provided under the National Insurance and Assistance Acts.<sup>2</sup> Again the Egyptian law seems to be inflexible and considers all benefits received as taxable income.

d. Exemption of friendly societies, trade unions, etc:

Taxation is not intended to inflict unnecessary hardship upon the individual. It is the main function of the State to collect taxation in order to assure a maximum social satisfaction of all. If exemption from taxation is allowed for any institution, it must be on the understanding that it performs a function "which the Government would otherwise be called upon to assume".<sup>3</sup> The registered friendly societies are of long standing in the British social structure. They were formed to insure their members against poverty and destitution. When income tax was imposed in Britain the members of these societies were below the exemption limit then prevailing and thus they were not subject to the tax.<sup>4</sup> The argument that these societies compete with life assurance companies did not prevent the continuation of their exemption, but certain limitations had to be set to suit the existing conditions. Now a registered society may be exempt from taxation if it assures to

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1. Ibid, p. 285

2. Ibid, p. 283 and Memento, p. 42

3. Seligman, Studies in Public Finance, p. 140

4. The Royal Commission on Income Tax, p. 67



any person a sum not exceeding £500 in gross or £104 a year by way of annuity.<sup>1</sup> The unregistered friendly societies can be exempted if its income does not exceed £160 a year. The exemption given in this case is from tax under Schedules A, C and D.<sup>2</sup>

Trades Unions are another form of association whose function is the performance of certain services to their members. They rank high in the British social framework and thus they are exempted from taxation on Schedules C and D, in respect of their interest and dividends which are provided to meet their purposes, and so long as they assure to any person a sum similar to that referred to in the case of the friendly societies. Trades Unions are treated in Egypt and France in the same manner as the non-profit and charitable concerns. They enjoy tax exemption only on their funds, but not on their investments or the utilisation of their capital. In Egypt the aid and annuities granted by them to their members are considered financial benefits subject to the tax. This seems to be harsh treatment of these organisations which are still young in Egypt.

Co-operative societies are other institutions which work mainly to reduce the cost of living for their members and assure their welfare. When the income tax was imposed in Britain they were fully recognised and the legislator had to exempt them from taxation.<sup>3</sup>

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1. Consolidation Bill, p. 344

2. Ibid, p. 344

3. The first attempt in co-operative movement in Britain was in Scotland in 1761, but the most influential one was the Rochdale Pioneers in 1844. See the Encyclopaedia Britannica.



Up to the time of the Royal Commission of Income Tax in 1920, the co-operative societies were exempt from taxes under Schedules C and D. on their trading profits, bank interest and dividends on investment.<sup>1</sup> Later on when these societies became well established and entered into competition with non-co-operative concerns, these exemptions were the subject of heated controversy and had to be withdrawn in 1933-4. But the co-operative societies are still entitled to an allowance in respect of payments such as: money actually expended for educational purposes; normal subscriptions to hospitals and convalescent homes from which the employees or members may derive benefit, subscriptions to Co-operative Guilds and subscriptions to the general fund of the Co-operative Union. But their payments for political purposes are not deductible costs. The members of the co-operative societies in Britain are liable to income tax on their share interest, and only the 'disposal surplus' which is regarded as a deferred discount, is untaxed.

Co-operative agricultural societies are of special importance in Egypt. The country is mainly dependent on agriculture and the peasants are relatively poor. The least the Government can do is to permit the exemption of the co-operative societies whose main object is raising the standard of living of its poor members through the reduction in the cost of their purchases, the elimination of the profits going to middle-men, and the increase in the power of bargaining. In addition to the exemption of the agricultural co-operative societies,

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1. The Royal Commission on the Income Tax, p. 119 ✓

the Egyptian legislator exempts other co-operative associations for consumption which limit their operations to the collection of the orders of their members, and to the distribution in their stores and warehouses of articles of food products and goods which are the object of these orders. The special privilege of the co-operative societies was abolished by a law passed in October, 1951, which leaves the condition more vague. The exemption allowed by that law covers all concerns which do not work for profit and all agricultural societies which are not in the form of joint stock companies (Art. 72, Law No. 174 of 1951).

Co-operative societies get more attention and widespread exemption in France. The legislator exempts from taxation co-operative societies for production, transforming, canning and selling the agricultural products. If they trade in a distinctive place other than the centre of production they will be subject to taxation at a half-rate.<sup>1</sup> Distributive co-operative societies are also exempt if they limit their dealings to their members.<sup>2</sup>

ie. Exemption to further economic development:

The problems of post-war reconstruction and the dire need for increasing productivity pressed the Ministers of Finance to give certain tax exemption for individuals or corporations to stimulate their efforts to this end.

We have noticed how Britain has provided special treatment in

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1. Laufenburger, op. cit. p. 171 and Formery, op. cit. p. 170

2. Formery, op. cit. pp. 247-8

favour of capital expenditure on scientific research since 1944, following the course taken in 1935, when deductions from profits of contributions for rationalisation of industry were allowed. The Egyptian and French legislators, in their turn, give more attention to constructional and development schemes. In France the extraction of oil is free from taxation because the need for oil is urgent and its prospects in the country are remote.<sup>1</sup> Similarly, Egypt exempts forest lands from taxation to encourage forest planting, and France gives a temporary exemption of 20 years for the same reason. Moreover, in France newly constructed buildings are exempt from taxation for the first two years, and flats constructed to let to the working classes enjoy an exemption for 10 to 15 years.<sup>2</sup>

(f. Other tax exemptions:

Egypt exempts agricultural profits from income tax except if they are realised by a joint stock company. The Taxation Committee of 1938 justified this action by the fact that agriculture had been the main source of taxation before any schedular income tax was imposed.<sup>3</sup> In reality the main source of taxation was and still is the indirect taxes which are largely borne by the masses. It is no exaggeration to state that land is undertaxed in Egypt. Behind this privilege is the dominating power of landlords in Parliament.

The professionals are another privileged class. They are exempted from the tax on professional income for the first five years of the practice,<sup>4</sup> a concession which has no parallel in the whole tax structure.

1. Laufenburger, op. cit. p. 171 and Formery, op. cit. p. 112

2. Memento Fiscal, p. 58

3. Report of the Taxation Committee, p. 54

4. Art. 71, Law No. 14 of 1939

In addition to these exemptions from taxation there are others which raise controversial points, and are better given in greater detail. The first is the exemption of State securities and the second is the exemption of savings.

(i) Exemption of State securities.

According to Seligman, the first obvious reason for the tax exemption of Government securities was war, when the need for revenue was great while credit was apt to weaken.<sup>1</sup> This practice which might be justified during a time of emergency was extended to normal times as an easy way of borrowing at a low rate of interest. In a static state and if the loan had to be redeemed by a fixed date one could assess the gain and loss of exempting State bonds from taxation. On the other hand, in a dynamic State, where the Government responsibilities tend to increase, pushing up the average rate of taxation and where tax-free State bonds are perpetual, it would be difficult to assess the net loss which would result from such a bond issue. De Marco, who held the 'capitalisation theory', thought that tax-free bonds are discounted and consolidated in the selling price.<sup>2</sup> Accordingly, if taxes on income increase and the rate of interest remains the same, then the price of tax-exempt bonds would rise and the State could step in and repay the loan, or convert it to another with a lower rate of interest, or even to other taxable ones. "The fallacy of this argument", according to Seligman, "is due to the fact that it neglects a consideration

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1. Seligman, op. cit. p. 140

2. De Marco, op. cit. p. 297



of the market conditions".<sup>1</sup> The tax-exempt State securities tend to nullify the progressive rates of taxation, to undermine the equity principle, to interfere with the flow of new investments to open the road for tax evasion.<sup>2</sup> The exemption works like a subsidy in the form of relief from surtax and with every increase in the tax rate a windfall of gains would be enjoyed by the bond-holders.<sup>3</sup> Contracting a loan, for other purposes than productive expenditure is in itself a favourable procedure to the high income brackets, as the State could, instead, impose a tax on them to meet such needs.

In spite of all these glaring defects, the Egyptian and French systems exempt their State bonds from taxation. This situation could be accepted in Egypt when the country was tied by the 'old' international obligations; but these obligations were dropped when the 'old debt' was converted in 1943, and other loans were contracted under favourable political and economic conditions. What is the most flagrant and least pardonable and indefensible act by the Minister of Finance is freeing the 'new' bonds from any future tax and thus giving a death blow to the supplementary graduated income tax which had been recently imposed. This exemption means the gradual increase of the obligations of those who are already taxed, by any increase in Government needs, especially if one bears in mind that the National Loan is timed and cannot be converted or redeemed before 1973.

In addition to the exemption of the National Loan, the Treasury

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1. Seligman, op. cit. p. 150

2. Allen, E.D: and Brownlee, O.H: Economics of Public Finance, p.240

3. Simons, op. cit. pp.175 et seq.



Bonds Mortgage Debentures issued by the Mortgage Credit Bank, and some other securities of the Provincial and Municipal Councils are also free of present and future taxation.<sup>1</sup> The aggregate amount of the tax-free securities in the market is not less than ££150 m. With an average rate of interest of 3%, and taxation at 25%, the total loss to the Government amounts to ££1.1 m. per annum.

In France the exemption of the National Defence Securities, Liberation Bonds and other treasury bonds seems to be influenced by political intrigues and the appalling economic conditions of the country. The problem is getting more complicated because of the tremendous increase in the issue of the tax-free Bons du Trésor. The amount of State bonds, which was 160 milliards francs at the end of 1940, reached 925 milliards francs at the end of 1948.<sup>2</sup> If the rate of interest on the latter amount is on the average 2% and the average rate of taxation is 30%, the aggregate loss to the State is 5.6 milliards francs per annum, and equivalent of the excess of 0.6% in the interest on the whole debt.

Only minor exemption is given in Britain to State securities and has little effect on the tax structure or the money market. The United Kingdom savings certificates issued by the Treasury "under which the purchase, by virtue of an immediate payment, becomes entitled after the expiration of a specified period to receive some greater sum" are not liable to the tax provided that the amount of these certificates held

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1. Cf. Al Rifaei, op. cit. pp. 233-4

2. Laufenburger, op. cit. p. 175

by the person does not exceed a certain figure authorised by the Treasury.<sup>1</sup> The exemption also includes the interest on the tax reserve certificates issued by the Treasury.<sup>2</sup> The importance of the non-exemption of State securities from taxation could be visualised by the fact that the high rates of surtax would be ineffective. The national debt in Britain became, to a great extent, self-supporting.<sup>3</sup>

(ii) Exemption of savings.

The problem of balancing the national economy after the war raised the issue of exempting savings from taxation.

J.S. Mill was alive to the needs of economic expansion during his time and justified, in his discussion, the adequacy of exempting savings and insurance premiums from taxation. He condemned the taxing of savings as being double taxation, a view which was followed later by the neo-classicists Marshall, Fisher and Pigou. The income of any person, emphasised Fisher, is that part which he can rightfully or properly use as income, and when savings are taken out of income, they become no longer income but capital.<sup>4</sup> Pigou puts it clear that "an income tax ... differentiates against saving, by striking savings both when they are made and also when they yield their fruits".<sup>5</sup> This Thesis is based on the assumption that nothing is income unless it is consumed and called on the remission of the tax expenditure, to the extent that this remission conduces to social progress.<sup>6</sup>

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1. Consolidation Bill, p. 122

2. Ibid, p. 124

3. Hicks, U.K.: Public Finance, p. 30 ✓

4. Fisher, I: Econometrica, Vol. 5, 1937, p. 23

5. Pigou, A.C: A Study in Public Finance, p. 118 ✓

6. Seligman in Encyclopaedia of The Social Sciences, Art. Income Tax

Savings are in reality income whose consumption is postponed. One cannot consider a part of income as capital in the same year of its formation. According to Bastable, "Income out of which savings are made cannot be the same as the subsequent income produced by these savings".<sup>1</sup> In taxing income and then the return of savings, there is in reality taxation in two incidences occurring in two different years. The fallacy of the notion of double taxation in taxing savings seems to need no more proof after Stamp, De Marco and MacGregor. The problem confronting us now is how to deal with savings in taxation as a socio-economic phenomenon. Balancing the national economy is of great importance and equality in distributing taxation is necessary too. Social and economic stability are the two faces of the coin of progress.

Generally speaking, savings are taxed in all the tax systems under comparison as they are means of income disbursement. On the other hand, some personal savings which are merely suspended expenditure to assure a stable standard of living for the person and his family, or to meet other unforeseen contingencies receive favourable treatment.

In Britain, as far back as 1853, Gladstone defended the grant of allowance for life insurance premiums as a mitigation of the taxation of savings. This allowance is probably responsible for the development of insurance sense in Britain and is a major factor in the prosperity of insurance companies. The Royal Commission on the Income Tax of 1920, justified the State "in looking with favourable aspect upon Life Insurance

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1. Quoted by MacGregor: The Economic Journal, Vol.46, 1936, p.393

and in treating income that is saved and applied in this manner with special indulgence", even if that meant unfairly acting against those who cannot save.<sup>1</sup> The existing British Income Tax law allows a deduction of one-fifth of the total income on premiums on a policy of insurance on the life of the person or his wife, provided it does not exceed a certain amount.<sup>2</sup> Policies taken out before 22nd June, 1916, receive special treatment and the allowance given fluctuates according to the size of the income.<sup>3</sup>

Allowances for insurance premiums are also granted in Egypt and France, but in the former country without limitation of the amount deducted in the case of the General Income Tax. This would open the road to fraudulent evasion and reduce the degree of effectiveness in the progressive rate.<sup>4</sup> Moreover, as insurance premiums are also allowed for deduction from the income liable to the tax on salaries and wages, the absence of clear rules governing such a deduction might lead to a double enjoyment.

## II. The Problem of Multiple and Double Taxation.

At the existing stage of world economic development the excessive need for taxation has resulted somehow in confusing the manner in which income taxes are levied. A constitutional conflict between the central government and local authorities might result in imposing a tax more than once on the same tax base. The State itself in using different

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1. Royal Commission, p. 65 ✓

2. Consolidation Bill, p. 143

3. Ibid, pp. 148-9

4. Art 7, Law No. 99 of 1949



conceptions to assess the taxable income might indulge in the same difficulty.

As between countries, the overlapping of the tax systems creates a problem of international significance. A person who is considered as resident in more than one country or as investing his money in other places than that of his domicile, becomes liable to a higher rate of taxation than another person of similar socio-economic standing who is subject to one tax jurisdiction only. Such an extra burden is a direct consequence of double taxation which, it is argued, is an important factor in disturbing international economic stability.

The problem of double taxation could then be studied in two spheres: within one country and between two several countries. To start with, it seems better to differentiate between domestic and international double taxation and use the term 'multiple' for the former case and 'double' for the latter.<sup>1</sup>

#### a. Multiple taxation.

It is important to clarify one point: that the imposition of a schedular tax and then a general tax is not multiple taxation because the latter impost is really a surtax.<sup>2</sup> Also, the taxpayer cannot complain of multiplicity "if all incomes were taxed twice at comparable rates" or if the income tax is supplemented by an E.P.T., because these

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1. The traditional term is 'double taxation' which was used by the League of Nations as well as by most of the writers on Public Finance. Lately the author of the 'Effect of Taxation on Foreign Trade and Investment' published by the United Nations in 1950 used the term international 'multiple taxation' instead of 'double taxation'.

2. Laufenburger, op. cit. p. 180



are cases of high tax and no more.<sup>1</sup> The multiplicity exists when some incomes are exposed to more than one tax while others are not.

Multiple taxation may be either intentional or unintentional. The former is mostly due to a certain legal confusion and the latter results from using more than one concept in assessing taxable incomes. These difficulties do not arise when the aggregate income of the individual is subject to the tax as a unit, as is the case of the British Income Tax.

The French legislator imposes the Com. and Ind. Profits Tax on legal entities and thus subjects corporations to a separate tax when they realise a profit; then when the same profits are distributed, they become subject again to the tax on Moveable Property. This duality is based on a false premise that the income of a corporation becomes a second income when distributed. Individual enterprises, on the other hand, pay the tax once when the profits are realised. This discrimination against corporations seems to restrict corporate formation and to limit economic development which is largely carried on by them.

In Egypt the tax on Com. and Ind. Profits strikes only that part which is not subject to the tax on Moveable Property, i.e. the undistributed profits. But again when this part is distributed in a later year, it has to bear the tax on Moveable Property. Taxpayers have complained against this injustice, but the cases brought to court against the ruling of the Taxation Department have not succeeded.

The Special Levy imposed in Egypt during the last war on cotton

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1. Taylor, op. cit. p. 432

transactions is another case of multiple taxation and is a clear violation of the equity principle. The levy discriminated against cotton dealers as it subjected them to that tax on their profitable transactions and in addition they had to pay the tax on Com. and Ind. Profits. Agricultural profits in Egypt also raise peculiar questions, for if any are realised by joint stock companies, the tax on Com. and Ind. Profits has to be paid in addition to land tax; but if agricultural profits are realised by an individual, he has to pay only the latter tax, thus putting joint stock companies in an unfavourable position compared with individuals.

This multiplicity in a tax which burdens certain categories of enterprises or profits can be avoided if we admit that the tax is paid in one way or another by the individual and that it therefore ought to be imposed on him but not on the forms of income as such, i.e. tax 'in rem'.

2. The problem of multiple taxation in a federal State is of great importance. It was even considered by Seligman as of greater importance than international double taxation.<sup>1</sup> Seligman showed the grievance of multiple taxation in his example of a man who might reside in one State, have his legal domicile in a second, derive his income from railroad securities which might be in a safe deposit vault in a third State; the railway itself might have its chief office in a fourth State, and its tracks might traverse several other States.<sup>2</sup> Where and how this

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1. See the Encyclopaedia of Social Sciences, Art. 'Double Taxation'.

2. Seligman, Income Tax, pp. 647-8.

income should be taxed, is undoubtedly puzzling.

In the three countries under discussion, the overlapping of judicial power is very limited and the local bodies are authorised to tax on a limited scale so as not to encroach upon the taxation structure of the Central Government. There is a ceiling in relation to income above which local taxes cannot rise without economic dislocation resulting.<sup>1</sup>

In Britain the rates which are imposed on persons occupying land and buildings<sup>2</sup> are the only levies permitted to local authorities. The French 'Communes' participate with the State in some of its taxes and are allowed to impose an additional amount on the 'old' direct impersonal taxes which are kept operative for this purpose and are limited by law of the State's General Council.<sup>3</sup> But they are not allowed by any means to tax profits or enterprises or the revenue of the individuals.

In Egypt the law allows an additional rate ranging from 8% to 11% on the existing taxes. When that law was made, the only functioning taxes were those on land and houses. During the last war the Provincial Councils extended the additional taxes to the newly imposed Schedular Income Taxes and the E.P.T. The Municipality of Alexandria levied a rate of 2.5% on the amount of the tax on Com. and Ind. Profits and on the tax on Moveable Property as well as an excess rate of 5% on the E.P.T.

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1. Hicks, op. cit. p. 272

2. Except in Scotland where the rates are imposed half on the owner and half on the occupier.

3. The 'Centimes Additionnels' are imposed on land, houses, patent or licence on commercial and industrial concerns and on habitation: See Laufenburger, op. cit. pp. 179 et seq and Formery, op. cit. pp. 374-5.

This procedure was followed by other provincial councils and one of them went as far as making the excess rate 10%.<sup>1</sup>

These additional imposts may not be within the exact meaning of multiple taxation but they can be included in this category because they raise the same problem.

This policy of the Local Authorities was fiercely criticised on two points: first, the constitutional right of these Authorities to levy such taxes, and, second, the repercussion of such levies on the location of industry and other business concerns. When the problem was presented to Parliament the Constitutional Committee of the Senate House emphasised the Constitutional right of the Local Councils to impose such extra rates.<sup>2</sup> The British Chamber of Commerce in Egypt attacked the taxes from another angle and condemned them as being unfair, penalising the companies whose head offices were in the jurisdiction of certain municipalities and threatening the dislocation of the administrative domicile of business.<sup>3</sup> This vigorous criticism brought in an amended law in September 1944 temporarily solving the problem and pointing out that "An additional tax on Com. and Ind. Profits may be levied by virtue of a law, on behalf of the municipal and village councils". Later on, the Government passed a Law No. 155 of 1950 imposing an overall excess tax of 10% above the Schedular Income Taxes for the benefit of Local Authorities except the Municipality of Alexandria which was allowed to retain its excess taxes. The legislator was careful when he drafted

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1. This was imposed by the Municipality of Mansourah, Official Journal 13.1.1944.

2. Official Journal, Parliamentary Ed. No. 24, 1944

3. The Journal of the British Chamber of Commerce of Egypt, May 1943, p.65



the tax on General Income for he prevented the local authorities from imposing any excess levy on that tax.<sup>1</sup> The main weakness of the local authorities intruding in the sphere of income taxation is the direct result of rendering ineffective the progression of the tax.

b. Double taxation:

The large scale exploitation of income taxation is responsible for aggravating the problem of double taxation. Every country is setting its system in the form which can bring in the greatest amount of revenue. In doing so, they imperil the free movement of work and capital in the international sphere and curtail the world's aggregate welfare. The problem of double taxation simply arose through the extension of tax jurisdiction and the overlapping of tax ideals and technique practised by different tax authorities, regardless of the personal status of the income recipient or his ability to pay.

(1) Theories underlying the imposition of income taxation.

To understand the problem of double taxation, from the point of view of the inter-relationship between the individual and the State, one has to clarify the arguments underlying the imposition of income taxation.

The two old theories of taxation are the 'cost theory' and the 'benefit theory'.<sup>2</sup> They sprang from the exchange theory which originated from 'social contract' hypothesis. Under the 'cost theory', it was held that one ought to be taxed in accordance with the cost of the service performed by the State. According to the 'benefit theory'

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1. Art. 23, Law No. 99 of 1949

2. See: Stamp, op. cit., Dalton, H: Principles of Public Finance, Formery, op. cit. and Profs. Bruins, Einaudi, Seligman and Stamp: Report on Double Taxation.



the tax ought to be imposed in relation to the particular benefits conferred by the State upon the individual. It is therefore a quid pro quo. Neither of the two theories is helpful in solving the problem of double taxation, especially if the individual is resident in one country and so enjoys some physical protection and civil rights. In the meantime his property may be situated in another country where it is maintained and defended from spoilation. Neither theory is adopted in the tax systems under discussion, as they limit the State functions, restrict its inter-relation with the individual and fail to consider the faculty of each taxpayer to bear taxation.

The two theories have been largely superseded by the theories of sacrifice, ability to pay and the Hobsonian theory.<sup>1</sup> They include what there is of value in the two old theories and are largely suitable for modern socio-economic conditions. The theories of sacrifice are based on the assumption that the tax constitutes a privation for the person who is subject to it. One believes that this privation should be equal as between the taxpayers; another suggests that the tax burden as a whole should be so arranged, so as to make the total direct real burden as small as possible. The 'ability to pay' theory starts from the supposition that there is an agreed amount needed by the State and that every individual ought to contribute to meet it in accordance with his financial ability. The Hobsonian theory is a product of the economic difficulties of the World War I. It emphasises the importance that the

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1. Ibid, Pigou, op. cit. Hicks, op. cit. De Marco, op. cit. and Allen and Brownlee, op. cit.

tax should not remove or impair any instrument of production or frustrate any element of consumption; thus the tax should only be on the 'surplus' after making allowance for risk-taking and for that portion which is necessary to stimulate industrial development.

These theories did not govern international competence in taxation, neither did they help to construct a solid basis for distributing tax burdens between nationals and foreigners, and between residents in the country and those who derive their interests from it. Besides, countries do not appeal to theoretical reasoning, but rather to their national benefit. They occupy different economic positions and their needs may be contradictory: they may be capital-importing or capital-exporting, and they may be under-developed or fully developed.

(2) Political and economic allegiance:

The problem facing every tax legislator is to what extent he can use political or economic allegiance as a basis for his tax formula and how to avert double taxation without sacrificing his country's interest, with minimum disturbance to the stability of the capital market.

Political allegiance has ceased to have any significance in Britain and France, but it is adopted in the Egyptian Income Tax system. Accordingly, all Egyptians are liable to the tax on their general income and remain so, even if they reside permanently abroad and derive no income from their home land. Such a practice is bound to burden the Egyptian citizen with more than one tax, and put them in a relatively unequal position compared with the foreign residents who might be exempted in their own country. The Egyptian tax legislation is ambiguous

and contradictory. On the one hand, the Schedular Income Taxes are levied on incomes derived from within the country except in the case of the returns of moveable property, which belong to citizens or residents and are derived from within or without the country. On the other hand, the legislator imposes the General Income Tax on the total income without reference to the origin of any part of it. That means that the taxpayer has to pay taxation on income which is already exempted from the Schedular Taxes.

Judging by the criterion of the political status or Political allegiance, the taxpayer is faced with a dilemma<sup>1</sup> that might have a certain bearing on his movements, his investments or even his retaining his citizenship altogether. The international movement of population and capital in our modern age makes political allegiance an inadequate test factor of individual fiscal obligation.<sup>2</sup> From the point of view of the State the application of political allegiance creates some technical and administrative difficulties which cannot be easily overcome.

The effect of this ruling in Egypt seems to be insignificant as the citizens who reside permanently abroad are very few. Even if they were subject to the tax, they are beyond the jurisdiction of their country and automatically the right of the State to claim the amount due from them lapses after five years.

The force of Economic Allegiance is the most significant criterion underlying modern tax structure. In the place of his permanent residence

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1. De Marco, op. cit. p. 301

2. League of Nations: Report on Double Taxation by Profs. Bruins, Einaudi, Seligman and Sir J. Stamp, p. 19

and the location of his wealth, the individual derives certain advantages; thus he ought to contribute to the expenses of the Government of his domicile and that of 'situs' in accordance with any adopted principle. The division among several Governments of the amount which the individual can afford to pay, depends on where his true economic interests are found, as the Scientific Experts of the League of Nations stated in 1923.<sup>1</sup>

The three countries under discussion lay stress on the principles of 'situs' and domicile with nearly equal emphasis to determine a suitable opportunity for double taxation. In using one principle or another every country is influenced by its historical development and generally follows what is thought to be financially desirable and economically expedient. The Fiscal Committee of the League of Nations, attributed double taxation to three factors: first, the co-existence of personal and impersonal tax liability; second, the application of different criteria in regard to personal tax liability, or different definitions of the bases of such liability, and third, the use of different tests of impersonal tax liability.<sup>2</sup>

In Egypt and France the taxes on the returns of land, houses and moveable property and on the profits of corporations, are impersonal. They are exacted from these returns when they are realised in their territory regardless of the personal status of the recipient. Britain in turn taxes income realised from foreign possessions, whatever the source, which might be brought into the country by one of its residents. Thus the resident in Britain who receives a profit earned in Egypt or

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1. Ibid, p. 20

2. League of Nations: London and Mexico Model Tax Conventions  
Commentary and Test



France will be exposed to double taxation. We have also noticed how the different interpretations of the terms 'resident' in Britain and in France would lead to double taxation.

The following table simplifies the practice of taxing income in each of the three States compared with that suggested in the London Bilateral Convention model to avoid double taxation drawn up for the League of Nations in 1946 counter to Mexico Draft of 1943.

<u>Source of Income</u>	<u>Preponderant Element</u>			
	<u>London Model</u>	<u>Britain</u>	<u>Egypt</u>	<u>France</u>
Real Property	O	O	O	O
Mortgages (property)	O	O	O&D	O
Mortgages on sea and/or air vessels	O(Reg)	O	O&D	O
Ind. & Com. or Agric. enterprises	x D	D	D	D
Operation of ships or aircraft	D	D	D	D
Labour or personal services	xx D	D	D	D
Liberal professions	x D	D	D	D
Govt. Payments not to Com. agents	O	O	O	O
Shares in Corporations	D	D	D&O	D&O
Shares belonging to foreign domiciled Co.	D	O	D&O	O
Bonds, Securities, Debentures etc.	D	D	D&O	D&O
Immoveable Prop., Mines, Quarry, etc.	O	O	O	O
Use of patent, Formula, Trade Mark	O	O	O	O
Pensions and Life Annuities	D	D	D&O <sup>1</sup>	D
All factors	xxx D	D	D&O	D

D = Domicile

O = Origin

- x If the person is considered as having more than one residence his tax liability in each place would be equal to what he got from services rendered there.
- xx If a person remains in a second State more than 183 days he shall be taxable therein in respect of the remuneration he earned during his stay there.
- xxx The State of domicile retains the right to tax the entire income, but deducts from its tax on such entire income an amount equal to the tax collected by the other State.

If the taxpayer is considered as domiciled in more than one State, the tax which depends on fiscal domicile shall be imposed in each State in proportion to the period of stay in each or according to any proportion agreeable to the competent administrators.

(See London and Mexico Model Tax Conventions, 1946)

1. If they were given for work done in Egypt.



The problem of double taxation is not considered a factor disturbing the fiscal structure in Egypt. As an under-developed country, Egypt does not have an important stake in relieving double tax burdens resting on the foreign investments of (her) own citizens.<sup>1</sup> She is more interested in deterring capital flight from domestic investment. Double taxation in this case acts like a tariff to keep capital from flowing freely outside the country. The legislator attaches great importance to the source of income as a tax criterion. The tax is a quid pro quo, in exchange for the profits gained from the country or "for the depletable natural resources taken out by foreign companies".<sup>2</sup>

No clear or powerful reasons yet show that the financial sacrifice of allowing any exemption for double taxation is compensated by real benefit to economic development.<sup>3</sup> For the time being it seems to be politically undesirable to grant any relief to foreign traders and investors as the people would find in it a return to the awkward system of Capitulations. The attempts made by Britain and U.S.A. to conclude bilateral conventions with Egypt on the prevention of double taxation, after the imposition of the Schedular Taxes in 1939, did not succeed. The Government advisers were against any such convention which did not prove to be of significant benefit to Egypt.

Britain and France had been aware of the problem of double taxation since World War I, but Britain was quicker to act to solve it. In 1916 and 1918 she granted temporary relief to persons dealing with the

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1. U.N.O: International Tax Agreements, Vol. II, p. XI.

2. Ibid, p. XI

3. U.N.O: The Effects of Taxation on Foreign Trade and Investment, p.4.

Commonwealth pending a permanent scheme, which was shortly afterwards adopted. The Sub-Committee of the Royal Commission on the Income Tax of 1920 stated that the essential homogeneity of the Commonwealth and the need for equity necessitated that, (a) no citizen of the Commonwealth was to be penalised because he invested his money outside his domicile; (b) the existence of double taxation would operate as a hindrance to the Imperial trade and the welfare of the whole; (c) it would be unwise to call upon any State to sacrifice more revenue than was absolutely essential; and, (d) the need for equity necessitated that such excessive double taxation had to be eliminated.<sup>1</sup> The Royal Commission then recommended a deduction from the appropriate rate of the British Income Tax equal to the whole rate of the Dominion tax charged in respect of the same income, provided that the exemption should not exceed one-half of the rate of the British tax.<sup>2</sup>

Several agreements were concluded with the Commonwealth and up to the F.A. 1950, relief of one half the amount of the corresponding British income tax on account of taxes paid to the Commonwealth was allowed. This relief was increased after 1950 to three-quarters of the tax, and after allowing 50% credit for all foreign taxes.<sup>3</sup>

The French do not seem to have given the same treatment to the investors in their Colonies, and no agreement of that sort has appeared in the collection of conventions published by the League of Nations and the United Nations Organisation.

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1. The Royal Commission, pp.169-170

2. Ibid, p. 16

3. International Tax Agreements, Vol. II, p.IX

The problem of double taxation was one of the main topics studied by the League of Nations and was called to the especial attention of its successor. The League's Scientific and Government Experts on double taxation submitted certain solutions and drafted model bilateral conventions as a guide to the Nations. But during the inter-war period agreements concluded were limited to international shipping enterprises and foreign commercial agencies. But since the end of the last war, with the spread of high income taxation, the desirability of freezing foreign trade and investment from avoidable encumbrances has become urgent.<sup>1</sup> The Economic and Social Council in its resolution of 1949 called on Member Governments to conclude bilateral agreements to eliminate double taxation.<sup>2</sup>

Between 1935 and 1950 the number of bilateral agreements concluded between Britain and other nations was 63; only 17 out of this figure were with nations outside the Commonwealth. In comparison, France concluded 7 and Egypt none. These agreements were on income and property taxes, on the taxation of Com. and Ind. enterprises and air and maritime transport enterprises.

The last of this chain of agreements up to 1950 was that concluded between Britain and France for the avoidance of double taxation, with respect to taxes on income (including surtax and profits tax). According to this convention "the industrial or commercial profits of a United Kingdom enterprise shall not be subject to French tax unless

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1. The effects of Taxation on Foreign Trade and Investment, pp. 34 et seq.

2. International Tax Agreements, p. X

the enterprise carries on a trade or business in France through a permanent establishment situated therein".<sup>1</sup> If the enterprise carries on a trade or business, it might be taxed by France, only on the part of the profit which is attributed to that permanent establishment. The same rule applies to the French enterprise which might be operating in Britain. If a Company is a resident of Britain<sup>2</sup> and derives profits from a permanent establishment in France, these profits shall not be subject to more than 10% for taxes on profits and moveable property. Moreover, profits which a resident of one of the contracting countries derives from operating ships or aircraft, is exempted from tax in the other country. The Convention dealt on the whole with most of the problems of double taxation that might arise between the two countries.

The awkwardness of the double taxation induced some liberal writers to support its termination for the sake of world welfare. For instance, Pigou said, "if all States were in an equally strong position for levying taxes on foreigners, it would be to the advantage of them all both collectively and individually, to enter into agreement not to make these levies".<sup>3</sup> And the Committee of Experts of the League of Nations recommended the division of income between origin and domicile in a priori manner believing that "what each country would lose in the one case it would roughly gain in the other". But the problem is further reacting<sup>h</sup> than the prerogative power of the State to impose taxation and

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1. See the International Tax Agreements, Vol. II, pp.115-122.

2. A Company is regarded in the Convention as resident in Britain if its business is managed and controlled there, and as having its fiscal domicile in France if its business is managed and conducted in that country.

3. Pigou, op. cit. p. 170

the unwarranted assumption that the interests of different countries in terminating double taxation are equal.<sup>1</sup>

Countries are of different economic standards and any proposal for this purpose "must satisfy the revenue needs of the taxing Government as well as the conditions under which desirable investment can be attracted to the country".<sup>2</sup> While the defects of double taxation are unpredictable, still the United Nations Conference on Trade and Employment in 1948 stated "it is doubtful whether super-imposition of taxes by several governmental authorities should be considered obnoxious per se and it is even more doubtful whether it is always restrictive of international trade".<sup>3</sup>

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1. Rao, V.K.R.V: Taxation of Income in India, p. 221  
2. The effects of Taxation on Foreign Trade, p.3  
3. Ibid, p. 36



## CHAPTER VI

THE IMPACT and INCIDENCE of INCOME TAXATION

Before going on with our analysis, a definition of the terms which are to be used is necessary in order to clarify their concepts. The change in the structure and PART III towards taxation results in the modification of these terms.<sup>1</sup>

The term IMPACT, INCIDENCE and SOCIAL EFFECTS of narrow sense and applied the term to the state of the final burden of the tax, in other words on whom the more immediate burden of the tax as a tax rests.<sup>2</sup> This indicated the short period consequences only.<sup>3</sup> But the term "incidence" will be used here in a more general sense to cover not only the initial burden of a tax but also the whole range of economic consequential changes in the long run as well as in the short.

The term "impact" will be used to mean the direct effect on the physical and moral entities who are legally responsible for the payment of the tax.

It should also be noted that the law of interrelation of prices gives an indication of the influence of taxation on the course of the supply and demand curves,<sup>4</sup> but one has to be careful not to commit the error of attributing certain phenomenal changes to the imposition of a certain tax or an increase in its rate is very rarely possible.

In a state of free selection, very many factors coincide to determine the value of any material. Some of these factors are

1. Hicks, U.K.: The Terminology of Tax Analysis, Economic Journal, Vol. 56, 1946, pp. 38 et seq.
2. The Colwyn Committee Report, p. 106
3. Black D.: The Incidence of Income Taxes, pp. 31-2
4. Von Mering, O.: The Shifting and Incidence of Taxation, p. 2.

CHAPTER VITHE IMPACT and INCIDENCE of INCOME TAXATION

Before going on with our analysis, a definition of the terms which are to be used is necessary in order to clarify their concepts. The change in the structure and outlook towards taxation results in the modification of these terms.<sup>1</sup>

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psychological and imponderable, a fact which immediately reduces our conclusions to mere indications of possible trends. Even then, no living community remains in a static state and allowances have to be made for the ex post hypothesis, and reliance on ex ante assumptions is not enough to help in understanding the interrelation of the factors which influence price determination.

When we speak about equilibrium it is also difficult to point to where it exists in a dynamic state. The Government imposes taxation which is borne by individuals and then it distributes what is collected in various ways to serve specific purposes. Every action in the body economico-politico is counted not specifically directly but rather in a complex diversity of movements. This dynamic course of action and counter-action makes an exact assessment of any one impost a very difficult, if not an impossible task. But this difficulty should not deter us from analysing the incidence and impact of certain taxes and employing certain statistics as probable indicators to the argument; at the same time we admit that any conclusion arrived at by such means is not proof in itself of the point under discussion.

The subject can be dealt with from different angles and the co-ordination of several factors in the socio-economic and political framework sets up varied problems which vary in importance according to the time and the state of the community. In the following pages we will limit our discussion to the problems which have faced Britain, Egypt and France in recent years, problems in which income taxes help or can help still in solving them.

# I. Income Taxation and the Problem of the Balance of Payments.<sup>1</sup>

The last war and the complications of its aftermath undermine the fundamental basis of international economic equilibrium in a way which threatens to disrupt the internal economic stability and menace the existing standard of living. The problem appears in a succession of adverse balances of payments which if not checked must be followed by the devaluation of the currency, intensification of inflation and increasing prices, then the adverse balance of payments and so on in a disastrous spiral.

The problem has a definite influence on planning financial policies. But before explaining the effectiveness of these policies in which income taxation has played a noticeable part, a diagnosis of the disease is essential.

Some may blame high State expenditure, especially on welfare, accompanied by excessive taxation as increasing consumption, sacrificing the future for the present, curtailing the incentive to produce and

1. The position of the balance of payments in the three countries after the war was as follows:

	<u>In Mn. Currency Unit</u>		
	<u>x Britain</u>	<u>Egypt</u>	<u>France</u>
	£	£E	U.S. \$
1946	- 348	- 19.4	- 2580
1947	- 558	- 13.7	- 1560
1948	- 26	- 12.2	- 1552
1949	+ 5	+ 4.9	- 735
1950	+ 244	- 14.0	- 218
1951	- 521	- 15.0	

x Including Grants

Sources: U.K. Balance of Payments Cmd. 8065 and 8505.

International Monetary Fund, International Financial Statistics, Vol. V, Jan. 1952. National Bank of Egypt, Economic Bulletin, Chancellor of the Exchequer, Economic Survey, Hansard Vol. 497, 1952, pp. 1273-4

pressing down the propensity to save.<sup>1</sup> Others may put the responsibility for the deteriorating situation on the selfishness of the richer countries, the excessive expenditure on rearmament, the increase of profit margins and the vast tax evasion.<sup>2</sup>

The problem confronting us therefore may be attributed to any of these reasons, or to certain inherent structural changes in international trade, accelerated by the war and the post-war political tension. The diversity of views seems to be instigated by differences in the politico-economic outlook and ideological hypotheses; these are beyond the present limited scope of analysis.

Whatever the reasons, the symptom of the disequilibrium in the balance of payments is the heavy drag on the resources of a country, with the result of pulling down its standard of living. In the free market the economic forces through the flexibility of the exchange rate and the movement of capital tend to restore equilibrium to the balance. But in a state of barriers and trade control the problem gets so much more complicated that one has to admit that the simple measures of the pre-war standard are ineffective.

There is a relationship between national income and the balance of payments equation. Changes in income entail changes in the same direction in the demand for imports. This in turn, tends to bring another change in exports and domestic income. Accordingly an increase in domestic income will swell the demand for imports and internal

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1. The Times, 22.8.1949

2. Balogh, T: The Dollar Crisis.



products unless the increment is set aside as savings. Similarly, a subsidy, is equivalent to an increase in the effective income as it reduces the price below the prime cost. If a subsidy is granted to imported goods, it will mean an increase in the 'marginal propensity to import' and increase imports unless that amount is limited. If it is granted to certain domestic products and services, it will result in stimulating the propensity to consume and reduce the volume of exports, unless the amount allocated for consumption is limited.

The country which subsidises imported goods, in order to assure a certain standard of living or employment, would place the exporting country in a better bargaining position than if the demand price were left free. If the mechanism of exchange adjustment is not sufficient to restore equilibrium, the propensity to import should be curtailed and the level of export increased. Consumption could be cut to the lowest point possible without causing health and efficiency to deteriorate.<sup>1</sup> And if a general cut in wages and profits could be carried over night, the adverse balance might be arrested without disturbing domestic employment.<sup>2</sup> But it seems that when the wage level has risen, any reduction would be strongly resisted;<sup>3</sup> also the entrepreneur would insist on increasing the margin of profit as an inducement to indulge in more risk-taking.

To solve the problem in a liberal manner, the Government can embark on several measures: (1) to reduce consumers' subsidies, which are

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1. Hawtrey, R.G: The Balance of Payments and the Standard of Living, p.66
  2. Nurkse, R: Domestic and International Equilibrium, The New Economics, Ed. Harris, p. 277.
  3. Hawtrey, op. cit. p. 21.

tantamount to a negative taxation,<sup>1</sup> (2) to raise the rate of taxation if it is low, carry the progression to a higher stage, and close the loopholes through which some <sup>incomes</sup> escape taxation; (3) to absorb some of the income through enforced saving, on the basis suggested by Keynes during the last war,<sup>2</sup> and encourage private saving. On the other hand, incentives to work and produce should be encouraged in a way that an increased margin of extra work should be lightly taxed and discrimination in taxation among firms could be maintained according to the degree of risk-taking. The export drive might also be stimulated if the price of exports were comparatively low.

The fiscal measures taken after the war by the three countries under consideration seem to be ineffective in bridging the gap in the balance of payments. The failure appears to be with the socio-political forces which prevent the fullest utilisation of economic factors. The opportunity for manoeuvring by any Minister of Finance is limited.

In Britain, excessive taxation is a legacy of the last war and its reduction after the war was not an easy job. It was considered as hampering the incentive to produce and to work and was even held in some quarters as being partly responsible for the relative increase in prices. On the other hand, the expansion of welfare expenditure seems to have gone further than was anticipated.<sup>3</sup> This policy of redistribution

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1. Ibid, p. 123

2. Keynes, J.M: How to Pay for the War

3. The highest estimate of the "Social Security Budget" as given by Beveridge was £697 Mn. in 1945 compared with the actual figures of £1156 in 1950. See Hagenbuch, W: The Social Services, London and Cambridge Economic Service, Vol. 29, 1951, p. 71

in favour of the lower income groups is alleged to be increasing the aggregate demand on consumers' goods and reducing the propensity to save and invest. In 1949 the net earnings of the manual workers including family allowances increased by 30% and for all workers by 27% compared with 1938.<sup>1</sup> In the meantime the level of output per man rose by 18%.<sup>2</sup> What is more, out of direct taxes on income collected in 1951, about 24.7% was returned in the shape of subsidies, an amount which is equivalent to 92.2% of the adverse balance of payments in that year.<sup>3</sup> Hawtrey rejects the criticism pointing "to the lavish expenditure on social services as a contributory cause of Great Britain's economic weakness",<sup>4</sup> simply because these services are met from revenue and do not involve any additional spending by the community. But if such a policy tends to diminish saving, as he admits, it is quite obvious that they would give rise to effective demand and lead to increasing the strain on the community's resources. That means a redistribution of the resources in favour of the less saving section, increases the amount of loose money which retains high standard of expenditure.

The outcome of these difficulties, the Chancellor of the Exchequer has expressed thus: "The state of the internal economy was such as to hamper the expansion of exports and to stimulate an increase of imports. Production did not increase so much as was expected and the Budget failed to produce any general decline in personal consumption".<sup>5</sup> The continuation

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1. U.N.O. Economic Survey of Europe in 1949, p.24 and Changes in Wages, The Economist, 28.1.1951
  2. Economic Survey, op. cit. p. 24
  3. Preliminary National Income and Expenditure Estimates, 1948-1951  
Cmd. 8486
  4. Ibid, p. 51
  5. Hansard, op. cit. p. 1273

of such a state of affairs would probably lead to unemployment. With nearly all sources of taxation tapped in Britain, the Chancellor does not have much choice except to return to the traditional policy that the rôle of the State can be more effective if the State turns to remove barriers to incentive, eliminate all forces hostile to innovation, and relax its grip on private enterprise. At the same time, the Chancellor has to take into consideration the reaction of any measure to a rather sensitive and powerful factor in production, i.e. the Trades Unions.

The Chancellor emphasised the discouraging effect of high income taxes on production and hard work and preferred to tackle the problem from the liberal side by increasing the amount free of tax and leaving the choice to the individual to consume or not the goods, the prices of which will be slightly increased.<sup>1</sup> The policy is designed to raise the starting point of tax liability, lower the rate on the earned income and make the graduation less steep.<sup>2</sup> To counteract political manoeuvres the Chancellor puts into operation an Excess Profits Levy, E.P.L. of a general character and not confined to concerns on armament contracts. The levy will apply to companies and other bodies but not to individuals. It is to be charged on the excess over the normal standard of profits, being the average of those realised between 1947 and 1949, at a rate of

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1. The cost of food subsidies was welcomed by some quarters and considered "not only as a means of restoring some realism to the national pattern of consumption, but also as a first step towards dismantling some of the swollen commitments of the State" so that when the defence emergency passes a reduction of the heavy burdens of taxation can be effected. See *The Economist*, 15.3.1952.
  2. Hansard, op. cit. pp.1304-5



30% and a compensating reduction to the P.T.<sup>1</sup>

The former proposal turns one's attention to the long debated controversy of direct versus indirect taxes on which Little shed more light, concluding that it is an illusion to suppose that, from the purely theoretical point of view, there is a case against indirect taxation. The supply of labour may be greater under suitable indirect tax than under direct tax.<sup>2</sup> Income Tax, which can be considered as a subsidy on leisure is a good tax only "in so far as the demand for leisure is highly inelastic".<sup>3</sup> As to the latter proposal it seems to contradict the main theme of encouraging production. An E.P.T. reduces the margin of competition and is inequitable in its incidence.<sup>4</sup> But still, if trading profits of companies increased in the same proportion as in the past year the E.P.L. will absorb 31% of that increase.<sup>5</sup>

In Egypt, unlike Britain, the rate of income taxation is very low as we have seen before and some sources of income are completely exempt. The tax therefore cannot be blamed for any adverse gap in the balance of payments which could be plugged if the income tax were utilised for this purpose. The main item in the foreign trade is cotton which forms

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1. Ibid, pp. 1291-2

2. De Scitovsky, T: The Reconstruction of the Theory of Tariffs. The Review of Economic Studies Vol. IX pp. 89-97 (1941-42)

3. Little, I.M.D: Economic Journal Vol.61, 1951, p.584 ✓

4. Hawtrey, op. cit. p.105 and F.B.I. Statement, The Times, 18.3.52.

5. The Financial Statement, 1952-3 and The Preliminary National Income and Expenditure Cmd. 8486



about 80% of the total exports.<sup>1</sup> Any rise in its price would cause a marked improvement in the balance of payments. The adverse in the balance is usually met by drawing on the accumulated sterling balances, by foreign loans and by a small amount of foreign investment.<sup>2</sup> Some of these measures are temporary and ways have to be explored to close the gap. It is suggested that a tax might be imposed on the allowances given to Egyptian tourists, who spent in 1949 an amount exceeding that brought in by foreign tourists by £E10.3,<sup>3</sup> which in itself is equal to about one third of the trade gap in that year. Besides, closing the loopholes in the income tax structure and imposing a tax on exempted income seems to be enough not only to return equilibrium to the balance of payments, but also to provide the Government with ample sums to execute some of the long postponed social and economic projects.

In the case of France it is noticed that she followed the course taken by most of the European countries after the war in expanding her welfare services and financing them by taxation. In addition to that, the wage structure was changed in favour of the lower-paid workers.<sup>4</sup> Real earnings including social services expanded by 20% in 1949 over those in 1938<sup>5</sup> while the output per man increased by 2% only.<sup>6</sup> In

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1. The proposition was 86% in 1950, see The Pocket Book of Statistics, Egypt 1949 and 1950.
  2. Hassan, A.M: The Problem of the Sterling Balances: The Bulletin of the Egyptian Education Bureau, No.45, May-June, 1950 and U.N.O. Review of Economic Conditions in the Middle East, p.18
  3. It is estimated that the figure was more than double that amount in 1951, see Hassan, A.M: The Financial and Economic Position of Egypt, The Bulletin No.51, January 1951
  4. U.N.O. Economic Survey, op. cit. p. 22
  5. Ibid, p. 24
  6. Ibid, p. 6

spite of that the proportion of national income allocated for personal consumption dropped by 9% which went to expand domestic capital net formation.<sup>1</sup>

The problem of the balance of payments took a different shape in France to that in Britain. France cannot cut her imports, which are mostly capital goods and raw materials,<sup>2</sup> or increase her exports, which are fundamentally consumers goods of a non-attractable type in such bad times. The traditional way to close the gap is to let the value of the currency drop and encourage exports and curtail imports.<sup>3</sup> From her liberation in 1944 up till 1949, the franc was devalued three times and its exchange rate with the U.S.\$/ fell by 86% in this period.<sup>4</sup>

With this background of instability the people are unwilling to hold franc currency; they keep their balances in foreign currencies, and invest them in domestic securities and real property.<sup>5</sup> The normal rate of taxation is comparatively high enough to make ends meet; but with the sharp fall of the exchange rate, the lag in the tax payment, the loopholes in the tax structure, the exemption of State securities, the favouritism of certain taxpayers accompanied by mass fraud, make the Government measures ineffective to solve the problem of the balance of payments.<sup>6</sup>

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1. Ibid, p. 23

2. The index of industrial production showed a fall of 56.5% in 1945 compared with 1938 level. See Bareau, P: The Economic Regeneration of France, Lloyds Bank Review, April 1947, pp. 19-25

3. The free rate in December 1951 was 433 frs. for \$, a reduction of 11% compared with the official controlled price. See International Financial Statistics, op. cit. pp. 44-5

4. Bareau, op. cit. p. 12

5. In the short run, France has to rely upon the Export Import Bank credits, sales of Gold and American aid.

6. Ibid and Coulter, S: French Taxes Without Tears. The Sunday Times, 2.3.1952

Thus income tax did not deteriorate a condition which was already inferior. On the contrary, the tax could have played its rôle in relieving France of its crisis, if the people did not bear a grudge against it and suspect any measure taken by the Government. The political instability, in its turn, prevents the utilisation of any kind of fiscal measure which might solve the problem. We have noticed lately the fall of Faure's Government whose proposals of an overall increase of 15% in income taxes and other increase in the companies tax did not receive the approval of the Assembly.<sup>1</sup> The new Government of Pinay is following a different course, based mainly on improving the tax administration and imposing heavy penalties for fraudulent evasion and cut-off expenditure.<sup>2</sup> Judging by past practice, it does not seem that income tax can be a stabilising factor in the unstable French conditions.

## II. Income Taxation and the Price Level.

Entrepreneurs often blame income tax for being a potent factor in inflating prices and depressing trade. This view recalls the question as to whether income tax can be shifted or not. This controversy is as old as the tax itself, and one cannot pretend that a satisfactory answer may be given in a short space of intellectual discussion.

The differences seem to arise, in the first place, from the confusion between the general income tax and partial income taxes; in the second, from considering the tax from the supply or from the demand side; and in the third, from understanding and weighing the rôle of the State in

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1. The Times, 25.2.52

2. The Economist, 15.3.52, p.634

the economic sphere.

The direct effect of the imposition of a general income tax is the curtailment of the purchasing power of the taxpayers. If the revenue was not expended by the Government and was more than what the people used to save or hoard, the demand for goods and services would be contracted and prices fall. This is because, in the short run, the supply curve remains the same while the demand curve drops. The decrease in demand which occurs because of the tax does not necessarily equal the amount of the tax, even if it is proportional, simply because of the differences in the elasticity of demand for the various commodities. In the long run supply will be altered as the factors of production are reallocated to suit the new position, taking into consideration the degree of flexibility of these factors.<sup>1</sup> The level of prices will then be determined by the point of intersection of the new supply and demand curves. This point will be down to the left or to the right according to the degree of falling of each curve. The policy which adopts a budgetary surplus as a measure to curb inflation assumes that the fall in demand due to the tax will be more than the fall in supply.

Taking the normal condition in which income tax is imposed and spent in a neutral manner, the question can be dealt with differently. The orthodox economists look at it from the producer's angle. They believe that income tax does not affect the price level. Having everyone taxed from whatever source he gets his income, there is no taxless field into

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1. Webb (Hicks) U: Taxation and Production. The Review of Economic Studies Vol. II, 1934, pp. 18-30



which he can escape. Paying the tax, the individual cannot improve his position by transferring his capital and energies to another business or occupation.<sup>1</sup> This might be true if the weight of the tax on the individuals and on the factors of production were the same. But the sensitiveness of the taxpayers is different, and their response to the tax would alter their relative state as consumers and as producers.

On the other hand the entrepreneurs argue that, as producers, they aim at obtaining a given net return on their capital and efforts, and that, if this return is reduced by increased income taxation, they will put up prices to recoup themselves for the difference.<sup>2</sup> If this view is correct then the measures taken to combat inflation by excessively taxing profits are ineffective and might worsen the situation. In reply, the Classical economists, followed by some contemporary writers, insist that income tax is imposed on the surplus over cost, and on the intra-marginal and not on the marginal producers, who do not realise any profit. Income tax, it is stated, is not a cost of production, "but a cost of success in business".<sup>3</sup> Profits are the result of a multiplicity of what perhaps may be very insignificant factors and it is difficult to foretell with any degree of accuracy the amount of profit before the end of the working period. Besides, business profits are a consequence, rather than a cause, of prices. Price is determined by supply and demand at a point close to the cost of production, and if a producer

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1. Seligman, *Studies in Public Finance*, p. 69

2. The Colwyn Report, p. 108

3. Dalton, *op. cit.* p. 82



dares to increase his supply price, under competition, he will lose to his competitors to the more efficient producers.<sup>1</sup> Even the monopolist, it is emphasised, who is after a maximum profit, cannot determine the market price.

All this is true if prices are determined by the non-profit enterprises which merely cover their outlay, but in actual conditions, prices are determined by profit-making concerns, which, in their various hazardous business spheres and activities require a definite margin of profit to cover the risk involved.<sup>2</sup> "If the enterprise is to pay its way" stated Hawtrey, "it must receive a price, for its product sufficient to cover prime costs and to contribute a margin towards overheads costs".<sup>3</sup> Compensation for risk is considered here as a cost. Following Marshall and his concepts of "normal profits" and the representative firm, a margin of profit should enter into the cost of production.<sup>4</sup> Enjoying one profit is not the procedure of the normal firm and could not be the one that determines prices in the short run. The greater the risk, the larger should be the margin; if this is not obtained, the individual may be reluctant to take the risk, and be content with a smaller, but a surer, return. This proves one point: that in calculating his costs the entrepreneur adds a limited margin for risk-taking but not all his remuneration, and he cannot possibly pass to the consumer his

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1. Seligman, op. cit. p. 70

2. Black, D: The Incidence of Income Taxes, pp. 5-17

3. Hawtrey, R.G: The Nature of Profit, Economic Journal, Vol.61, 1951, p.493

4. Interest and insurance on all capital are considered as part of the cost. See Robertson, D.H: The Colwyn Committee, The Income Tax and the Price Level, The Economic Journal, Vol.37, 1927, pp. 199 et seq. See also Hotelling, H: The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates, Econometrica, July 1938

"disproportionate burden of progressive taxation".

In normal conditions, the entrepreneur as an individual, motivated by profit urge, "tries to introduce or to maintain a difference between his selling price and his buying prices or costs of factors".<sup>1</sup> It is true that he can influence the latter factor more strongly than the former through systematic research into possible internal and external economies. But every increase of taxation depriving him of this difference may discourage his activity or make him rely on achieving the same end through combining some economic units. The former attitude tends to keep the costs high and the latter results in centralising production in bigger units, which may be able to curtail competition, so as to keep a quasi-monopolistic margin.

Excessive taxation and excess profits taxes in particular, falling indiscriminately upon increments of profit tend to weaken the natural resistance of the entrepreneurs to increasing costs, especially wage demands. No amount of pressure will ever persuade the business man to reduce costs and eliminate waste spending so long as the most, if not all of his extra profits are seized by the State. Thus high taxation might inflate prices but would not depress them. If enough allowance is not given for depreciation, depletion and obsolescence, taking into consideration the changing value of capital, efficiency will deteriorate marginal costs will rise and competition for foreign markets will

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1. Marchal, J: The Construction of New Theory of Profit, The American Economic Review, Vol. XLI, 1951, p. 551

2. Hicks, J.R. and Others: The Taxation of War Wealth, p. 44

probably collapse.

Clark shows that in any non-totalitarian community 25% of the national income is the limit for taxation.<sup>1</sup> If the proportion were to exceed that amount, the condition would become sensitive to a drop in the value of money and the community would become willing to accept such a depreciation.

A tax on the general income is accepted by those who believe in the principle of neutrality. It would yield maximum revenue with minimum interference in the individual actions. But those who believe in the need for influencing the allocation of resources and the distribution of income and wealth, adhere to the system of partial taxes through which such aims could be attained.

Unlike the general income tax, the partial income taxes are widely considered shiftable. It is obvious that, generally speaking, an individual will not continue to keep his capital or employ his energy in a particular kind of activity which is subject to a special tax or to a comparatively higher tax, if by transferring his capital or energy to some other field he can enjoy a higher net return.<sup>2</sup> The shifting of a tax depends on its rate, the manner in which it is imposed and the nature of each factor of production. If the rates of the tax on the returns of each factor are different, as is the case in Egypt, the allocation of

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1. The limit in the countries where wealth and income are more equal is about 20%, see Clark, C: Public Finance and Changes in Value of Money, *Economic Journal*, Vol. 55, 1945, pp. 371-389
  2. Seligman, op. cit. p. 66, Webb (Hicks) U: Taxation and Production, op. cit, and Benham, F.C: Taxation and the Relative Prices of Factors of Production, *Economica*, Vol. II, 1935, pp.198-203

the factors would possibly be altered. Generally speaking, the demand on the factors of production is derived from the demand on their products and the value of these factors are determined by the rate of their returns. If the rate of return changes, owing to the imposition of a tax, the new equilibrium will be determined by the changes caused by demand on the factors under the new conditions. The shifting of any factor of production from one position to another will, of course, bring about an increase in supply in the new position, and a decrease in the old one, a new point of equilibrium of locating the products will thus be determined. Before any such change can take place, however, the owner of the factor has to take into account the cost of shifting and the possibility that others will shift too to the favourable position. If the owner of the factor discovers that these fresh difficulties have rendered a shifting hardly worth while, he may retain it in its original position. This does not mean that no change is likely in the field of investment, as it may be expected that new investments will be diverted to where the return is more profitable.

The other important factor which affects price determination and should not be ignored is State policy in expenditure. The revenue is usually spent in varied proportions on administration, defence, social welfare, constructive projects and on aid for industry and trade. If taxation means a curtailment in the money income of the taxpayers the expenditure will have a counter effect by increasing the real income in the shape of social and economic security. Through a better arrangement



of the factors of production, the State can increase the national dividend; and through redistributing the returns amongst the members it induces an augmentation of the aggregate welfare. This would occur when, according to Pigou, "the real yield of the last unit of resources expended by the Government (is) equal to the real yield of the last unit left in the hands of the representative citizens".<sup>1</sup>

Under normal conditions, with the State interfering as little as possible in the economic and social field, the disturbance caused by its expenditure will have little effect on the allocation of resources. But in the case of embarking on a policy of a large scale interference, the repercussion on the allocation of resources will be significant. The propensity to save and consume will be radically changed and the effective demand will be such as to alter the general level of prices. Besides, the policy of transferring a quantity of money from where its purchasing power is low, to where the purchasing power is high, will tend to change both the value of money and the price level. Keynes' view on this fact is worth quoting. In 1923, referring to the level of the franc, he stated that such a level "is going to be settled in the long run, not by speculation or the balance of trade,... but by the proportion of his earned income which the French taxpayer will permit to be taken from him to pay the claims of the French rentier".<sup>2</sup> In Britain the distribution of income before and after income taxation, in the post war period, shows that the relative proportion which was lost by earners of

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1. Pigou, A.C: Studies in Public Finance, p. 34 ✓

2. Quoted by Clark, op. cit. p. 372



rent, dividends and interest was mostly gained by wage earners.<sup>1</sup>

After this discussion one has to come to the conclusion that income taxation has a certain bearing on the level of prices and on the allocation of the factors of production. The British system of preserving unity in income tax is superior from the point of view of neutrality in the economic field. It spreads the burdens on the returns without discrimination.<sup>2</sup> The Egyptian system on the other hand is criticised by economists and business men as creating arbitrary means through which certain activities are favoured at the expense of others. The supporters of the system think that the differentiation in the tax rates, if well studied, might assist in some indirect planning. This opinion cannot be taken seriously because the differentiation is often employed to satisfy certain pressure groups. During the last war, when the need for revenue was urgent, the only schedule which bore the brunt of the increase was commercial and industrial profits. In the meantime, the agricultural section escaped paying any excess tax over its pre-war level. The defect of such a system of partial taxation made France divert from it in 1948. France now imposes a standard rate on the returns of all factors but she still adopts the system of separate treatment.

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1. Proportions gained and lost:

	1946	1947	1948	1949	1950
Wages	+3	+3	+2	+3	+2
Rent, Dividend, etc.	-4	-3	-3	-3	-3
See National Income and Expenditure Cmd. 8203					

2. Hicks, U.K: The Finance of British Government, p. 249

The excessive increase in the rate of income taxes in Britain and relatively in France, while it was expected to curtail consumption and was thought to be effective in coping with the problem of inflation, has proved to be disappointing and even to result in an adverse reaction.<sup>1</sup> Any increase in income taxes is graduated on the different classes, with the middle and upper strata of the community bearing the largest part. This tends to reduce savings or the funds available for investment,<sup>2</sup> but does not reveal the main evil which is a case of more money chasing a shrinking amount of goods.

Clark's calculation that taxes cannot exceed 25% of the national income without resulting in a depreciation in the value of money seems to be less by 5% than the maximum limit reached in Britain in the post war period.

If the existing welfare state has to be accepted, an amount of 30% taken out of the net national income seems to be the maximum for taxation. This amount is similar to that stated by the Physiocrat, Baudeau.<sup>3</sup>

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1. Kalecki, M: See Studies in War Economics, p. 91
  2. Hicks, U.K: The Finance of British Government, p. 250
  3. Gide, C: and Rist, C: History of Economic Doctrines, p. 39

The following table follows Clark's example and shows the changes in the cost of living index and the amounts and proportion of taxation exacted from the net national income in Britain.

Year	Cost of Living 1948 = 100	* Taxes	in £ Mn. % of National Income	* Taxes on Income	** National Income	Central Govt. Surplus or Deficit % on c/a N.I.
1946	89	2642	31.7	1209	8311	- 12.3
1947	94	2679	30.2	1025	8876	- 5.2
1948	100	2989	30.2	1056	9896	+ 4.4
1949	103	3216	30.1	1190	10671	+ 4.7
1950	106	3294	29.7	1353	11089	+ 5.9
1951	115	3553	30.9	1464	11532	+ 4.6

\* Minus subsidies and E.P.T. refunds

\*\* Minus depreciation

Sources: National Income and Expenditure Cmd. 8203 and  
Preliminary National Income and Expenditure Cmd. 8486.

In the first two years the Anglo-American loan was operating; in the following year aids through European Recovery Programme, E.R.P. were granted. The devaluation of the £ occurred in September 1949 with a reduction of 30.5% in exchange with the U.S. \$.

In the case of France the position appears to be different as the deterioration in the value was instigated rather by other powerful factors than by those of taxation. Income taxes take only about half the proportion, taken by the British tax from the national income. All taxes absorb from 17.6% to 26.3% in France<sup>1</sup> compared with about 30% in Britain. But in spite of that, changes in prices in France are

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1. The figures used for the national income are taken from the International Financial Statistics are even lower than those calculated by the French Ministry of Finance, cf. Revue d'Economie Politique, Mars-Juin 1951, pp.200 et seq.

more violent, as can be seen in the following table; (the absence of a strict price control system in France similar to that in Britain has to be allowed for).

Year	Retail Price 1948 = 100	Taxation % of N.I.	Direct Tax % of N.I.	Nat. Inc. Mld. Frs.	Central Govt. Deficit % of N.I.
1946	39	17.6	3.4	2618	12.9
1947	63	20.7	5.4	3303	12.0
1948	100	19.3	5.3	5430	14.4
1949	109	22.7	5.8	6530	10.3
1950	121	26.3	7.9	7395	8.2

Sources: Ministères des Finances, du Budget et des Affaires Economiques: Inventaire de la Situation Financière 1951, and International Financial Statistics, op. cit.

No similar comparison can be drawn with Egypt, but it is quite evident that taxation which ranges between 8% and 10% of the national income cannot be expected to be markedly responsible for the deterioration in the value of money.

Another cause of the failure of income taxes and surtaxes as fiscal measures to stop price increases once they have started, is their slowness in collection. Owing to the methods of accounting and the technical difficulty of assessment, income tax is collected not on current but on past income and some years may elapse before full payment is enacted.<sup>1</sup> During time of rising prices, such a lag, which is tantamount to giving taxpayers loans without interest, would accelerate inflation.<sup>2</sup> It is

1. Hicks, U.K: Lags in Tax Collection, The Review of Economic Studies Vol. VIII, 1940-41, pp. 89-99

2. In France and Egypt the lag in tax collection is even worse and considered as a contributory factor in accelerating inflation.

noticeable that arrears of E.P.D. appeared in the Inland Revenue Reports during World War II.

It seems that the best method of taxing at a time of inflation, with reference to income tax is to exact the largest proportion from the sources which are capable of producing revenue more quickly.

### III. Income Taxation and Employment.

Full employment has been the major issue of public policy since the great depression of 1930. Having the tool of taxation, it is argued, the Government could utilise it in order to achieve full employment. Economic thought has had to work out the implications created by this new factor.

The Classicists assumed the existence of a self balancing state, in which the economic forces are capable and powerful enough to restore equilibrium whenever it is disturbed. In such a state, all factors of production are fully utilised and the returns are equal at the margin. Thus it can never appear more than frictional unemployment or sectional over production.<sup>1</sup> Any interference in the setting of this natural order, as they understand it, will result in a chain of counteractions till the equilibrium is again restored. The stronger the interference, the longer would be the time to regain such equilibrium and the greater the community's loss. Taxation is considered here as a sort of interference since it means a diversion from the natural order and the deflection of some resources of members of society "from purposes which

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1. Schumacher, E.F: See The Economics of Full Employment,



they would have selected for themselves to purposes which are selected for them".<sup>1</sup> Thus it should be limited so as to inflict as little as possible on the economic structure.

When the socio-economic pattern gets more complicated, it becomes apparent that no invisible hand, declares Pigou, "can be relied on to produce a good arrangement of the whole from a combination of separate treatments of the parts".<sup>2</sup> Accordingly, the State can use taxation to increase the aggregate welfare by imposing it on industries working under the law of decreasing return and subsidising those governed by law of increasing return. But in following such a course, the principle of private property should be preserved, as it is the corner stone of progress.<sup>3</sup> The Marshallian adherents retain the assumption of equilibrium even if 6% or 10% of the working people are unemployed, because the social loss involved in such a case is insignificant.<sup>4</sup> The appearance of a slump is attributed to the failure of the State and its class allies, central banks and other local organisations as well as to the inflexibility of wages.<sup>5</sup> It is through an economy campaign and settling wages in conformity with prices and reducing taxation, that the problem of unemployment can be overcome. There is no clear case to accept the superiority of State actions over those of individuals; nor does the success of State management during a war make a *prima facie* case for its being equally successful in time of peace.<sup>6</sup>

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1. Wicksteed, P.H: Common Sense of Political Economy Vol.II, p. 660 ✓
  2. Pigou, A.C: The Economics of Welfare, p. 195
  3. Marshall, A: Principles of Economics, p. 48
  4. Pigou, A.C: Employment and Equilibrium, p. 15
  6. Pigou, A.C: Economics of Welfare, pp. 336 and 549
  5. Pigou, A.C; Economics in Practice

The reduction of taxation in the case of slump would increase the margin of saving in individual hands, and an increase in investment would thereby follow. But to embark on a policy of free grants would not solve the problem. Marshall has made it clear that transferring money from the well-to-do and giving it to the needy group, if not accompanied by an increase in the earning power of the coming generation, might tend to lower future wages.<sup>1</sup>

Economy measures as a way of solving the problem of unemployment proved to be futile and helped to worsen the situation,<sup>2</sup> not only in Britain but also in Egypt and France. The problem was too acute and complicated to be solved by leaving the economic forces free to act and the Government to be neutral. The number of unemployed in Britain in the inter-war period ranged between 10% and 22%; in Egypt it was even more. In France nearly one-third of the industrial production capacity was idle.<sup>3</sup> It became true, declared Keynes, that the Classical theory "represents the way in which we should like our Economy to behave. But to assume that it actually does so is to assume our difficulties away".<sup>4</sup>

The problem looked like one of under-consumption rather than one of over-production and the Keynesians tried to solve it accordingly. Their formula of "Investment Multiplier" is significant for it combines the degree of propensity to consume with that of investment. They defined it as being equal to a reciprocal of one minus the marginal

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1. Marshall, A: Official Papers, p. 225

2. Robinson, J: The Problem of Full Employment, p. 33

3. Bareau, op. cit.

4. Keynes, J.M: The General Theory of Employment, p. 34 ✓

propensity to consume. Thus any small portion of investment would result, by successive movements, in creating a case of full employment. In a state of confusion and uncertainty the Government has to play a part side by side with the factors of production.<sup>1</sup> It can execute a scheme of public works and other welfare projects to increase the propensity to consume which in its turn would accelerate employment.<sup>2</sup> Even digging holes in the ground would achieve the purpose, if nothing else could be done. This theory has dominated the economic planners and policy makers in Britain since the Coalition Government set up during the last war. The Beveridge plan of 1942 and the Employment Policy of 1944 were designed on the former lines and with the main object of supplying certain social welfare services and thereby increasing the propensity of society to consume. This intention was revealed in the White Paper on the Employment Policy when it was stated that the standard rate of continuation for a social insurance scheme "would be assessed on the basis of a forecast of the average level of unemployment".<sup>3</sup>

The same tendency is reflected in the policies of most of the world in the post-war period as most of the countries either executed or "have accumulated reserves or "shelves" of public works to be put in operation in a case of a decline in employment.<sup>4</sup> In 1949 a committee of international experts made some recommendations in order to maintain full

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1. Ibid, p. 380

2. Ibid, pp. 129-131

3. Employment Policy Cmd. 6527, p. 23

4. U.N.O: Maintenance of Full Employment, p. 15

employment. They said, "where effective demand is deficient, it can be augmented by increased government expenditure or reduced taxation" if the standard of taxation is high enough that any reduction would be adequate.<sup>1</sup> The idea became generally accepted that deliberate and continued action should be taken by Government in order to maintain effective demand at full employment level through changes in taxation and expenditure.

The post-war conditions in Britain and France did not need much interference to accelerate full employment. The demand for labour to rebuild the shattered economy was so immense that some industries were facing the problem of lack of manpower. There was no urgent need for any outside injection of effective demand. In spite of that the two Governments were engaged on vast social and economic schemes which created a situation termed by some economists as "over-employment". Some of these projects were necessary to fulfil certain promises given during the war, but most of the expenditure has exceeded what was thought to be necessary or adequate. A large proportion of the national income was used to effect certain changes in the economic pattern so as to satisfy political ends with no direct relation to the problem of full employment.<sup>2</sup> Such an extensive policy implied a comparatively high

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1. U.N.O. National and International Measures of Full Employment, p.77

2. In Britain projects to nationalise coal mines, gas, electricity, railways and some other means of transport, the Bank of England and a section of the steel industry were executed. Similar projects were carried through by France, embracing coal mines, the railways, gas, electric generation and distribution on important section of the engineering industry, the Bank of France, the four large deposit banks and the insurance companies. See Bureau, op. cit.



level of taxation and an inevitable diminution of saving.

The need to rearm afterwards threatens to break down economic stability and it became clear that unemployment might follow. Economists did not explain the exact ratio, when speaking about "consumption-income", to assure full employment.<sup>1</sup> Hansen believes that in the midst of institutional development we tend "to lower the ratio of consumption to income and to increase the proportion of income saved"<sup>2</sup> which does not fit in with the problem concerning Britain nowadays. The excessive dose of "consumption-income" does not work as a stabilising factor but rather as an inflationary one threatening to disrupt stability. A large part of the resources is dominated now by the Government in Britain and comparatively little margin is left to individual enterprise. It is feared that if unemployment on a considerable scale were to occur, it would be quite difficult for entrepreneurs to engage in worthwhile investment schemes, simply because taxation had eaten up most of their reserves and what had been allowed for depreciation and depletion was far from enough to pay for renewals. As for the people, they would become in less need to save or take the risk of investment. The number of unemployed is increasing now; their figure reached 393,000 in February 1952, with an increase of 60,000 above the average for the past four years and 91,000 more than in February last year. A rearrangement of State expenditure has to be made and a reduction in its rate seems to be necessary to reduce the rate of taxation. But what items of

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1. Perloff, H.S. in *Income, Employment and Public Policy*, p.204

2. Hansen, A.H. *Fiscal Policy and Business Cycle*, p. 238



expenditure are to be cut is a matter which can be settled nowadays only by politicians rather than economists.

If the expenditure problem cannot be easily solved, there is left the tax structure which could be rearranged in a more favourable way. The system of imposing one tax on the unified income, was quite acceptable when the neutrality of the State was thought to be necessary. But since the imposition of additional taxes on profits this neutrality is disappearing. Income taxes could be imposed on the separate schedules according to a formula embracing risk-taking, the nature of the factor supplying the return and the ability of the income earners to pay. If the administrative machine renders the suggestion difficult, a differentiation between earned and unearned income could be introduced through the imposition of a "poll tax" or by lowering the starting point for surtax.<sup>1</sup> But if neutrality is still insisted upon, personal allowances could be cut, a standard income, comparatively lower than the existing one (about £500) would be taxed at a flat rate and additional tax could become payable by charging a higher rate on the excess over that amount.<sup>2</sup>

In spite of the difficulties facing the Chancellor of the Exchequer in Britain, he is still following the right track - unlike his counterpart in France. In the post-war boom and full employment period, the French Budget was "underbalanced" either because of tax evasion or because of the exemption of certain classes or incomes. This deficit budgeting, which threatens to be a permanent feature is stimulating inflation and

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1. Meade, J.E: Planning and the Price Mechanism, pp.105-7

2. Chambers: Taxation and Incentives, Lloyds Bank Review, April 1948

thereby increasing the cost of production. The problem of the unemployed might be dealt with if the budgetary balance were restored. Then, through differentiating the tax on the earning of each factor of production, encouragement could be given to the section able to expand its investments and increase its demand on labour.

With reference to Egypt, the problem of unemployment is a feature of an over populated country with a small minority dominating its wealth and the vast majority extremely poor. The Government's finance sways towards favouring the former with the result that not only their share in taxation is small but also State expenditure is designed in such a way as to benefit them. In 1949-50 only 10% of the budgetary receipts were collected from Schedular income taxes, 5% from taxes on property, 50% from indirect taxes, and the rest from State Railways and State domain etc.<sup>1</sup> Allowing money to fructify in the pockets of the rich classes seems to be damaging the economic stability of the country. In the first place, the absence of a reasonable standard of education, of health and of training facilities lowers productivity and reduces national income. In the second, the more affluent classes have not the initiative or grasp of the situation to direct their behaviour towards productive investment. They either spend most of their income on buying land without reference to its return<sup>2</sup> or engage

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1. Pocket Book of Statistics, Egypt, 1949 and 1950

2. Land is the most coveted and respected kind of ownership, thus demand on it is widespread and keen. The tremendous increase in the demand for it without equivalent increase in the supply results automatically in a continuous increase in the price.

in stock or cotton exchange speculations. Gregory proposed that public investment of any type would be beneficial to the underdeveloped world. Up to a certain point, "there is no real cleavage of national advantage between the investment in the building up of public capital, of roads, offices, school buildings, hospitals and the like, or in expenditure in intangibles such as doctors and trained personnel of all sorts."<sup>1</sup> A high rate of income taxes when spent by the Government would increase "income-creative" power in the community and would tend to readjust the demand on each factor of production in a more rational way. This solution is confined to conditions where the profit motive of the individuals is inferior and cannot be relied upon to achieve an economic good.

With the State taking the initiative to employ the increasing surplus of labour it does not need to base its calculations on any rate of return<sup>2</sup> or even to limit its programme to certain projects of public utility pattern. The adequate ratio taken by taxation in such a case may be limited by the amount necessary to achieve full employment but not to disturb the allocation of manpower in the employed section.

#### IV. Income Taxation and Incentives:

A rational economic policy is that based on maintaining a high standard of living. In conformity with this principle taxation has to

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1. Gregory, Sir T: The Problems of the Under-Developed World, Lloyds Bank Review, Oct. 1948.
  2. Strumlin, S.G: The Time Factor in Capital Investment Projects, See International Economic Papers No.1, p. 164

be planned so as to be kept low where it interferes with production level, and high where it does not.<sup>1</sup> It is important then to study the impact of taxation on the motives that lead individuals to produce.

Production depends on the twin factors, capitalists and labour. In an individualistic state, these factors are motivated by the profit urge or by the superiority in competition according to Schumpeter's modernised assumption or by a blend of psychological and social as well as economic interests, according to Groves.<sup>2</sup> In each case, the main interest of the capitalist lies in employing his money on any right of value he acquires at an acceptable price. The labourer in his turn has a store of energy which he can dispose of at an suitable reward. A high tax rate on the return of either of them, other things being equal, would restrain his economic motivation. And with every increase in its rate, the more would be the need for incentive so as not to let production go down.

The imposition of taxation on business concerns as such is likely to restrain business activity more than taxes upon individuals.<sup>3</sup> Business production and ownership are distinct from each other because the entrepreneur can still manage successfully and increase production, even if the reward of the shareholder is limited. The need for more revenue has compelled the Government to impose taxes on profits of enterprises; but successive increases seem to hamper risk-taking, and short term investments. To-day in Britain, income and profits taxes

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1. Bough, R: Conflict and Harmony in Taxation, See Viewpoints on Public Finance, Ed. Groves, p. 719

2. Groves, H.M: Production, Jobs and Taxes, p. 11

3. Ibid, p. 11



absorb, on the average, approximately 5% of all taxable profits compared with just over 30% in 1938.<sup>1</sup> This high proportion of taxation in addition to the imposition of E.P.L. seems to discourage risk-taking. The latter tax which was originally meant to curtail rearmament profiteering, is levied in such a way as to hit every industry so long as its profits exceed certain standards. Thus it penalises success and puts a premium on stagnation.

The imposition of a flat rate on the profit of industry as is the case in Britain, Egypt and France, without reference to its status, whether it is monopolistic or not, and without considering its productive nature, whether working under increasing or decreasing returns, is bound to increase the relative power of the monopolistic type of firm and discourage the competitive. Per contra, a relative increase in the tax rate of monopolistic firms and those working under decreasing returns, would work as a bounty for efficient firms.<sup>2</sup>

The investor is an important element in production. He is motivated in his decision by the reward he receives from investing his savings. The greater the reward, the stronger is the propensity to invest. But the higher the tax, the less is the propensity to save and invest. It is important then that taxation should not increase enough to slacken saving during a time of inflation or to divert individuals to short time investment or speculation, in a way to reduce the average risk-taking. In post-war Britain and France there is an indication

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1. The proportion will reach 63½% by the new budgetary measures. See Wincott, H: The Equity in Eclipse, Lloyds Bank Review, April 1951, and The Times Review of Industry, April 1952, p. 7.

2. Birck, L.V: The Theory of Marginal Value, pp. 200 et seq.



that investments are directed to State securities.<sup>1</sup> These are the less risky investments and are favoured in France because of their exemption from taxation.

Examining now the relation between taxation and the amount of effort, we find Pigou gives the order of merit among tax formulae to poll-taxes, regressive income taxes, proportionate taxes and lastly progressive taxes.<sup>2</sup> But that does not mean that the principle of equity in taxation can be sacrificed or that poll-taxes can be enough to supply the Government needs. Progressive taxation may be adopted even though it discourages a small section, if the bigger section, by being exempted from or benefited by State expenditure, were to increase its productivity and morale.

It may be agreed that the best tax system is that of 'the least aggregate sacrifice' but it seems to be impracticable in our present state of affairs. Such a tax formula would lead, as Edgeworth asserted, to a kind of dull equality and upset the function of maintaining and developing knowledge and culture and tend to cripple those of higher quality.<sup>3</sup> It would greatly affect the taxpayer, and leave him with little margin of interest after the tax.<sup>4</sup>

The excessive progression in the British income tax seems to depress initiative and drastically reduce the incentive to work. When the effective rate on an individual income reaches 94% (when that income

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1. Wincott, op. cit. and Bureau, op. cit.

2. Pigou, *Studies in Public Finance*, pp.67-9 and Henderson, *Economic Journal*, Vol. 58, December, 1948

3. Edgeworth, F.Y: *Papers Relating to Political Economy*, Vol. II, p.104

4. *Ibid*, p. 111

is £100,000), it is expected that no urge will induce him to increase his income. The inevitable consequence is the destruction of a fertile source of a tax. Some taxpayers might be tempted to smuggle their money out of the country for investment abroad where the rate of taxation is lower and the prospects are brighter. Others might direct their attention to deals in antiques, paintings, old books and ornaments which increase in price through time. The number of contributors to surtax in Britain decreased by 7545 between 1947-8 and 1949-50, and the net tax assessed was reduced by £18.2 Mn. The number of income earners over £100,000 decreased from 93 in 1938-9 to 39 in 1949-50, in spite of the increase in prices.<sup>1</sup> High progressive income taxation will inevitably reduce the supply of highly productive personal services. It will render saving on a large scale difficult, thereby diverting these same sources from "capital-creation" to consumption uses.

The effect of income tax on the incentive to work depends on several factors which are interdependent, such as the quantity of the individual's elasticity of demand for income in terms of effort, the type of work, the tax formula and the policy of State expenditure, in addition to the personal psychological reaction. If the individual is interested in earning a certain amount of income, then any reduction of that amount by taxation will induce him to work harder. But this principle is objectionable, as being too harsh and undemocratic. Its application would lead to social conflict, as it results in making the

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1. Inland Revenue Reports 1947 and 1951

sacrifice regressive according to the level of income. It is thought that if increasing production is the intention, it would rather be better to leave more income untaxed, the more the work is being done. The more attractive the real income is the more will people offer their work.

The individual who is free to supply his labour or withhold it, compares the utility of income and leisure with the disability of work, and tries to equalise the marginal unit of pleasure with the pain experienced in achieving it.<sup>1</sup> The more the income received, in other words, the greater the pleasure it confers on the person through its use, the less will be his desire for more work.<sup>2</sup> Thus when net income after tax is comparatively high, and can assure a reasonable standard of living, it is left to the State to call on individuals through other ways to increase their production.

In most of the fields of salaried enterprise, the position looks different, for both work and remuneration are fixed. The taxpayer cannot increase his amount of work to earn more, to pay for his increased taxation, nor can he reduce his liability by cutting down his output.<sup>3</sup> In Britain where joint-stock companies dominate the field of production, and in normal conditions, only a little part of the resources is idle, the individual has at best only a scanty chance of adjusting his output of work to his liability for taxation. That does not mean

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1. According to the Marginalist School, work is connected with pain

2. Jevons, W.S: The Theory of Political Economy, p. 176

3. Colwyn Committee Report, p. 380

that heavy taxation has no direct reaction on the amount of work. When they are heavily taxed, the workers may press for increased wages, for a reduction of working hours, and for a longer holiday with pay, or they may refuse to do extra work and abstain from their job.<sup>1</sup> The demand for labour may be high, but if the reward after taxation is low, some married women would withdrawn their work from the market and be content to do their housework instead of depending on a domestic at lower salary.<sup>2</sup>

During the last war the percentage of absenteeism from coal production in Britain gradually increased until in 1943 it doubled the pre-war figure and reached 16.3% in 1945 compared with 6.4% in 1938.<sup>3</sup> In spite of the increase in the earnings by about 134% between 1938 and 1949, still the percentage of absenteeism was doubled.<sup>4</sup> Our example will illustrate the position. If a worker earned £400 a year in 1950 he had to pay a tax of £55. 10. 0. when his earnings through overtime increased, he was obliged to pay a progressive percentage; on the first £50 he would pay £12, and on the second £50 the amount of tax would be increased by another £18.<sup>5</sup>

In Egypt and France the rate of income tax is very moderate and

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1. Hicks, U.K: Public Finance, pp. 218-9 ✓
  2. Paish, F.W: Economic Incentive in War Time, Economica Vol. VIII, 1941, pp. 239-248
  3. One has to take into consideration that some absenteeism was due to war conditions
  4. Annual Abstract of Statistics 1938-1949
  5. In 1941 the sudden rise of the curve between zero liability and a marginal rate of 6/6 is obviously deterrent to personal effort, cf. Hicks, U.K. op. cit. p. 216

progression is of a low degree so as not to hamper the incentive to work. If the rate of taxation is high, the reaction on labour force will be clearer because a large part of labour is still free to move in the field of production and a substantial position of the resources is idle.

To solve the problem of incentive through taxation measures is not easy in Britain. Any increase in the wage bill would widen the inflationary gap. If the necessary consumers' goods are rationed and purchase tax on other goods is high, the worker cannot enjoy the pleasure of earning more, because either he will be prevented from exceeding his ration or he will not get much if he consumes other goods. And if an important part of the services on which he would have spent his income are supplied gratis, e.g. welfare services, it seems doubtful that he would care much to work overtime or increase his productivity. The inducement to work harder, in a welfare state, seems to be small, unless a sense of patriotism develops. To write down the welfare expenditure in Britain may look hypothetically easy, but actually, it is rather difficult, because of the existence of a strong labour groups whose co-operation in production and whose votes in elections are fundamental to a stable condition.

In a state of suspicion between employers and employees, the Government could appeal to the patriotism of both groups and ask for an extra one or two hours of work every week, the price of which could be listed separately and put at the Government's disposal. If this



appeared impracticable a differentiation of the rate of taxation according to the type of work could be made and a reduced rate on overtime earnings could be applied. There is another possibility: freeing consumers' goods from rationing and limiting their prices after allowing a small margin for producers and traders, other welfare services to be left untouched. If political manoeuvres rendered the abolition of rationing impossible, it could be limited to a minimum and anyone who exceeds the minimum of work needed could be supplied with personal coupons entitling him to buy extra rationed materials. In this case no special rate of taxation for extra earnings is needed.<sup>1</sup>

Another suggestion was made by the Liberal Party in 1949. It was based on sweeping away the present system of income tax allowances by assessment, imposing a flat rate of income tax on all incomes and replacing allowances by a system of weekly basic payments to all persons, children as well as adults. The high rates of taxation and personal allowances tend to be dangerously negative in effect and to place a premium upon leisure. A flat rate of 5/- in the £ was thought of as the maximum at which anything approaching full incentive can be preserved. A supplementary tax on the higher income groups, exceeding £600 per annum, at a rate of 2/- for earned and 3/- for unearned incomes.<sup>2</sup>

But however logical a scheme may look, it needs the approval of

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1. Mrs. Hicks suggests a return to the traditional methods of collection but to support the tax with a simple proportional tax deducted from all wages and salaries at a low rate. op. cit. p. 221.
  2. Reform of Income Tax and Social Security Payments, a Liberal Party Yellow Book.

the interested groups who seem to be motivated by their personal interest rather than by any common principle.

Being in control of the social order, the State demands from each individual a certain amount of sacrifice in order to meet its obligations which are gradually increasing in the course of natural development or international tension. The distribution of these obligations amongst the citizens is quite complex, as the position of the individual in society is very different than in other organisations. In society there is a compulsion for sacrifice without personal reciprocal benefit. It is for the individual and immeasurable benefit of the whole that material and even physical sacrifices have continuously to be made.

It is agreed that equality in distributing such a sacrifice or burden should be the governing principle of any State. But this equality is not an absolute criterion, it differs according to the socio-economic structure of society and to the determinant philosophic ideal. Some of these differences may arise from the varied conception of the State. The State may be considered but a juridical establishment, with no material reality<sup>1</sup> and functioning within a limited mandate. Others may consider it a creation of society to look after its common interests with unlimited power to fulfil this pledge.<sup>2</sup> "The State is indeed not an organism and still less a superorganism",<sup>3</sup> but it is unquestionably a means to an end. It has to function in such a way as not to impair

1. Evanger, M: Les Finances Publiques, p.8

2. List, F: National System of Political Economy

3. Selligman: See Viewpoints in Public Finance, op. cit. p.4

CHAPTER VIISOCIAL OUTLOOK ON THE EFFECT OF INCOME TAXATION

Being in control of the social order, the State demands from each individual a certain amount of sacrifice in order to meet its obligations which are gradually increasing in the course of natural development or international tension. The distribution of these obligations amongst the citizens is quite complex, as the position of the individual in society is very different than in other organisations. In society there is a compulsion for sacrifice without personal reciprocal benefit. It is for the individual and immeasurable benefit of the whole that material and even physical sacrifices have continuously to be made.

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1. Duverger, M: Les Finances Publiques, p.8

2. List, F: National System of Political Economy

3. Seligman: See Viewpoints in Public Finance, op. cit. p.4

the productivity of any factor in the socio-economic order or hamper the increase of the aggregate welfare of the community. The decisive measure in any controversy should be the equalisation between the marginal private and social net product.

To have an accurate picture of the degree of equity and sacrifice in a specific tax formula is impossible except in reference to the taxation structure of which it forms part.<sup>1</sup> Any desirable tax distribution could be obtained in a system where the faults of one tax would be offset by the virtues of another.<sup>2</sup> Moreover, the effects of a certain tax system on the determination of income and wealth allocation, cannot be judged without studying at the same time State policy in the field of expenditure.

But as our study is confined to income taxes, the following discussion can be taken as explaining their probable social effects. In addition, it should be remembered that such effects would, in their turn, tend to influence the shape and size of the national income in the long run.<sup>3</sup>

#### I. The Equity and Justice of Income Taxes.

The terms 'equity' and 'justice' have no objective sense; they are expressions of relative states of human consciousness.<sup>4</sup> They cannot be taken as such but in comparison with a certain unified measure or standard; not in a vacuum or isolation but in an actively dynamic society composed of individuals of conflicting behaviour, ideas and aims.

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1. Edgeworth, op. cit. p. 130

2. Hicks, U.K: Public Finance, p. 150

3. Hicks, U.K: The Finance of British Government, p. 265

4. Sidgwick believed that 'equality' is good in itself. See Pigou, Studies in Public Finance, p. 5.

This subjectivity in the terms 'equity' and 'justice', may bring varied meanings to different classes of people and may make any enquiry rather inaccurate, unless a certain standard of judgment is assumed.

In a community composed of different individuals, motivated by self-interest and aiming at maximising their satisfaction through money terms, any revenue being raised by the State is bound to inflict on the individuals a certain sacrifice and cause a decrease in their satisfaction (ignoring the counter effect of State expenditure). The distribution of this sacrifice amongst the contributors has been and still is the subject-matter of heated controversy. But before proceeding with our analysis let us assume that similar situations produce similar mental reactions and that similar individuals in similarly situated positions would be treated similarly.

J.S. Mill linked the conception of 'equality' in taxation with a humanitarian and ethical criterion. He thought of apportioning the continuation in such a way that each individual should feel neither more nor less inconvenience from his share of the payment than every other person experienced from his,<sup>1</sup> after providing for a certain minimum of income sufficient for the necessities of life, discounting savings and amounts destined for insurance premiums. Accepting equal sacrifice does not denote that taxation should be proportional to the individual's income, as Mill erroneously thought.<sup>2</sup> The proportional rate may be

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1. Mill, J.S: op. cit. p. 805

2. Edgeworth, op. cit. pp. 237-8



acceptable on the marginal assumption if the marginal utility of income, after the limit of exemption, does not diminish at all, as income increases. It may also be justified if all incomes are received from the work of people of equal social and economic status and if such incomes are equivalent to the pain inflicted on the receiver. But in actual life, income is derived from different sources, people are in different positions, and, in general, the positive relation between the size of income and the energy expended by the earner is insignificant.<sup>1</sup> In such circumstances, the rate of taxation has to vary according to the several factors affecting income as well as the position of its earner. In the meantime progression has to be applied, with rates following the income utility curve, increasing with the steepness of the curve rather than following the rectangular hyperbola.<sup>2</sup>

Deduction from "the greatest quantum of happiness principle" is that of 'minimum sacrifice',<sup>3</sup> which denotes that the total direct real burden on society should be as small as possible. The abstract mechanism of that principle would result in the richer being taxed "for the benefit of the poorer to the point at which complete equality of fortunes is attained".<sup>4</sup> In the case of any specific amount of taxation needed, it has to be exacted by slashing the tops of the higher incomes.

In practice the principles of sacrifice are difficult to accept as

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1. In some cases the relation between work and income is negative.
  2. Ibid, pp. 107-8
  3. Ibid, pp. 103 and 241
  4. Pigou, op. cit. p. 103

satisfactory measures of equity, for they rely on arbitrary inter-personal assessment of utilities. Individuals differ in their behaviour, judgements and responses.<sup>1</sup> Besides, to the individual who experiences it, sacrifice is not a common article but a relative state. The principle of 'least aggregate sacrifice' is further criticised as being unjust in penalising the individual for augmenting his income over a certain amount and thus erecting a barrier against superiority and the symbol of success.

In practical experience, tax systems do not usually follow any specific theoretical formulae, because they are resultants of different politico-social and economic components in society. When these components are balanced, it can be said that the taxation structure is more equitable than when they are unbalanced. In spite of this fact, the commonly desirable principles in an ideal tax system seem to provide a sort of modified formula of the 'least sacrifice'.

A minimum standard of welfare for every individual has been generally recognised for many years in Britain and France. Progress towards that end was accelerated at a high rate in the last fifty years. The two countries tried to secure such a minimum not only through exemption from taxation but also by direct grants and subsidies, a process which implies a comparatively high level of taxation on the richer classes in varying degrees.<sup>2</sup> In Egypt, the rich classes have

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1. Kendrick, M: The Ability to Pay, See Viewpoints in Public Finance, p. 19.

2. The Economist gives an interesting comparison between British and French welfare state in relation to taxation. See The Economist March, 22nd, 1952, pp. 735-6

the upper hand in directing public policy and run it in a way to assure their own superiority. It can be logically expected that the proportion of taxation out of national income is small.

About 40% of the British national income is surrendered in direct and indirect taxes compared with 38% in France and only 8.5% in Egypt.<sup>1</sup> Of these amounts over 50% is raised from income taxation in Britain compared with 30% in France and 25% in Egypt. Assuming that income taxes are borne by the comparatively better-off classes, these figures would indicate that the poor section of the people are more severely hit in Egypt compared with those in Britain and France; and that while the French pay nearly as much of their national income as the British, yet most of the burden is regressively distributed.

a. Equity in the distribution of tax burden in Britain:

The distribution of the income tax burden shows the same tendency. In Britain income derived from business and professions while amounting to about a quarter of the net true income in 1949-50, yet bore more than half the income tax collected, as seen in the following table:-

Sch.	In £ M.				Total
	A	C	D *	E	
Net True income	396	203	2478	6353	9430
Net produce of tax	102	81	776	488	1447
Tax in % of Income	25.8	40.1	31.3	7.7	15.3

\* Income derived from the occupation of land being usually under Sch. B, was transferred to Sch. D.

Source: Inland Revenue Report, 1951, Cmd. 8436.

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1. Preliminary National Income and Expenditure Estimates. 1948-51 Cmd. 8486; International Financial Statistics Jan. 1952; Inventaire de la Situation Financière 1951; and Estimates of National Income by the Egyptian Statistical Department.

Moreover, 42% of the income tax came from the group incomes of £2000 and over and only 19% was contributed by the groups whose income was less than £500, as shown in 1949 figures given below.

Range of Income £	No. of Incomes in 1000	Income and Surtax paid in £ M.
Under 250	-	24
250-500 499	10310	186
500-1000	2443	239
1000-2000	545	189
2000-10,000	219	324
10000 and over	11	146
Total:	-	1108

Source: National Income and Expenditure of the U.K.  
1946-50, Cmd. 8203

The rate of progression in the British system is so sharp that it creates an income ceiling of about £9400 per annum (1949-50 rates) which one had to get from a taxable income of £223,500.<sup>1</sup> It is little wonder then that the number of taxed incomes on the latter amount was only 40, according to 1949-50 assessments.

This tax distribution can well be considered as equitable and in conformity with the principle of 'least sacrifice'. But to what extent such a system is just is a matter of controversy. The low income groups hail it because it frees them from being any noticeable fiscal obligation and gives a high value to their labour. The middle classes complain that it depresses their faculties and lessens their chances to plan for a better future. The high income groups in their turn consider it as a destructive process to the natural order of

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1. Being the highest average income according to Inland Revenue calculations, Sec. Report, 1951, Cmd. 8436.

difference, penalising great efforts for more production.

Criticisms are unavoidable so long as the attitude to the State and individual obligations towards society are confused. But what is of special interest is the women's view. They comprise over a quarter of the working population in Britain<sup>1</sup> and are enrolled in a lower scale reward compared with men. If the law of marginal utility is applied and a woman gets the same satisfaction as a man in consuming a unit of income, then the utility of a unit of income in terms of effort would be higher for a woman than for a man at the same income level. This necessitates that so long as 'equal pay for equal work' is not applied, a scale of less progressive rates should be adopted when taxing the earnings of women.

b. Equity in the distribution of the tax burden in Egypt:

The Egyptian tax structure and the tax returns are clear indications of how the system is based on a kind of politico-social and economic favouritism worse than that practised in France. The holders of State securities are completely immune from income taxation, present or future, with the result that every increase in the demand for revenue has to be borne by other sections of the community. This exemption gives them unrequited benefit which increases with every addition to taxation. The second favoured section in the community is that which derives its income from agriculture. Agricultural profits are exempt from Schedular taxes unless they are formed by joint-stock companies,

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1. U.K. Annual Abstract of Statistics, 1938-49



the profit of which are comparatively low. The amendment of October, 1951, emphasised this exemption and put off all attempts by the Taxation Department to override that rule. Besides, when the tax on general income is applied, agricultural profits are calculated according to the rental values (minus 20% for maintenance), which are already under-estimated.

No material is available to show how the national income is distributed among different income groups or how each income group contributes to the tax. In spite of this difficulty the mal-distribution of wealth and income is not denied and the figures for land ownership give some indication of the state of affairs in the whole economic field. About 94% of the owners hold not more than five acres and their aggregate holdings are 35%; at the same time about 0.4% hold over 50 acres and their holdings equal 35% of the total land.<sup>1</sup> While wealth and income are concentrated in the hands of a very small number and the proportion of income tax out of national income is small too, most of the burden seems to be borne by the middle classes, and specifically by the section who pay through 'the stoppage at the source' mechanism, i.e. wage and salary earners and receivers of income from moveable property.<sup>2</sup> The imposition of the tax on general income does not seem to have improved such a situation; even the later increase in the rate of progression

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1. These figures are for 1949. See the Pocket Book of Statistics, 1949 and 1950.

2. It was estimated in 1942 that income-earners of over ££120 per annum contributed ££16.5 m. in taxation, while the rest of the population paid ££14.1 m., leaving some ££15 m. derived from small taxes and fees or representing the income of State enterprises. See Issawi, C: Egypt, p. 142.

and the sharpening of the sliding scale would not result in an effective change. The expected receipt from the General Income Tax for the Budgetary year 1951-2 is about 30% of the total yield of income taxation.<sup>1</sup>

Between 85% and 90% of income taxes are contributed by those who derive their earnings from commercial and industrial activities. Income from moveable property provides about one-third of the former figure. Most of the burden is borne by the middle classes whose activities are concentrated in individual and partnership concerns. In the case of earnings from moveable property the rate is flat and no concession or allowance for personal needs whatsoever is granted. Earners of commercial and industrial profits secure some suitable allowances provided that income does not reach more than the allowance figure; apart from that the tax rate is flat. Such proportional taxes are against the equity principle as they inflict a more awkward burden on those in the lower brackets than on those in the higher brackets as well as disproportionate enjoyment.

The same trend can be found in the tax on non-commercial profits. Up till 1950 liberal professions were taxed according to the rent of their premises. When severe criticism was waged against such favouritism, they were made subject to the same sliding scale as was applied to wages and salaries, in spite of the disparity between the two groups. According to a recent change in October 1951, they became subject to a

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1. The new sliding scale is 8% for incomes between ££1000 and ££1500 (£1025-1537). See National Bank of Egypt, Economic Bulletin Vol. IV, No. 4, 1951

flat rate, thereby hitting severely the low income groups compared with those on the high reaches.

Such inequality in distributing public burdens breeds a sense of insecurity and a feeling of distrust of the governing classes, who are suspected by the people of running State affairs for their own ends. This widespread feeling, strikes a heavy blow at private ownership and disturbs the investment of capital. It might also create a kind of politico-social tension which would threaten to disrupt the social framework and economic stability.

c. Equity in the distribution of the tax burden in France:

The French system is more suitable for tax discrimination and can be more effectively employed than the British if a tax formula is made so as to account for sacrifice in parting with one's income, the relative difficulty in acquiring that income and the differences in the size of income attributed to differences in the nature of the factors of production. The British system was designed, as we have seen, at a time when the neutrality of the State concerning individuals was held to be best suited to maximise welfare, and when the nature of income itself in relation to the factors of production was not very clear.

In spite of that the French system is employed in such a way as to provide undue privileges to the rich and agricultural classes, in addition to the loopholes which mostly benefit people of complex income. The graduation of the tax on which an equitable distribution could be arrived at is not effectively carried out. The progressive surtax (the tax on general income) is based on the Schedular taxes, which are badly

managed. State securities are free of tax, some incomes are calculated according to fictitious assessments or taxed at lower rates, and even 'the stoppage at the source' principle which was put into practice in 1939 for income derived from work, and was held to be a technical improvement, was terminated in 1949.<sup>1</sup>

The tax burden is shared by most of the social classes in France. About 70% of the actual income is taxed there compared with 56% only in Britain.<sup>2</sup> The average rate of taxation in France in 1950 was 34%. Over one-third of the revenue (36%) came from the taxes on societies' profits and income from moveable property; salaries yielded about one-fourth; the proportional tax on other schedules supplied 18.5%; and the progressive surtax produced one-fifth.<sup>3</sup> These proportions may give a vague idea about the distribution of income tax in 1950 according to the type of income but do not reveal what class pays most of the burden.

The distribution of the national income in 1947 and the yield of income taxes on the main schedules as seen in the following table shows that the rate on salaries was more than double that on agricultural profits. One has to remember that the agricultural section of the people are largely favoured, and that in 1948 about 88% of the taxpayers in that section were assessed at a lower rate.<sup>4</sup>

	In Mld. Frs.		
	<u>Salaries &amp; Wages</u>	<u>Industry &amp; Commerce</u>	<u>Agriculture</u>
Amount of Income	1500	960	500
Taxes paid	78.7	87.9	12.5
Proportion	5.2	9.2	2.5

Sources: Inventaire de la Situation Financiere et Brochier op. cit.

1. Duverger, op. cit. pp. 53 et seq.
2. Laufenburger, op. cit. p.81 and Inland Revenue Report 1950
3. Inventaire de la Situation Financière
4. Duverger, op. cit. p. 54



The surtax is not even graduated as sharply as in Britain. It starts from a comparatively low margin, being 10% on incomes between 120,000 frs. and 250,000 frs. (£123-255) and 60% on incomes exceeding 3 million frs. (Over £3061).<sup>1</sup> This maldistribution of the tax burden is contrary to the main principle on which the French system was originally based.

## II. Income Taxation and the Redistribution of Income and Wealth:

An equal distribution of income and wealth has been advocated at different times for different ends. Some ideologists would consider such an equality as synonymous with justice and admit that only in a classless society can socio-economic harmony be expected. Others attribute our social difficulties and economic disequilibrium to the prevailing state of inequal distribution which is far too deeply implanted in our economy.<sup>2</sup> Those who are less extreme are cautious about taking such a hypothesis for granted; for if inequal distribution can be criticised "equal distribution is at least questionable".<sup>3</sup> Absolute equality is not only quite impracticable but would also inflict vast damage on the economic welfare of society as it would tend to check production and disappoint the legitimate expectations of individuals.<sup>4</sup>

Whatever our view, the growth of resentment against great inequality runs parallel with political equality. A state of affairs in which "some live without working and others work without living", as Loria

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1. Memento Fiscal, p. 62

2. Fisher, A.G.B: Full Employment and Income Inequality, Economic Journal Vol. 56, 1946, pp. 18-26

3. Smart, W: op. cit. p. 100

4. Dalton, H: Inequality of Income, p. 21



stated,<sup>1</sup> seems to contradict the basis of democratic life. Maldistribution indicates that a certain amount of waste of potential economic welfare exists, because the less urgent needs are 'over satisfied' and the more urgent ones are 'starved'. According to Gossen, only a definitely limited number of units or atoms has value, and any further addition will be valueless to the individual. On the other hand, the value of a unit to an individual in the lower strata of society has no doubt a value much more than zero. If one assumes that the greater the difference in the scale of distribution, the stronger will be the conflict of individual interest, the utility of some units in certain directions would mean a disutility to society as a whole. In order to create by means of exchange a maximum of value, every single article must be so distributed among all men that the last atom of any commodity, which each receives, represents for him the same value as the last atom of his commodity for any other - a theory emphasised by Gossen.<sup>2</sup>

With the existence of maldistribution of income in a society using units of money of the same purchasing power, the factors of production seem to be allocated not according to their utility, but according to their position in the schedule of effective demand. The utility of a unit of income, while being subjective, yet changes according to the status of the individual in the economic and social stratum and the means by which the distribution of the national dividend is enacted.

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1. Quoted by Dalton, Ibid p. 4.

2. Stark, W: The Ideal Foundations of Economic Thought, p. 161.

Inequality, like disequilibrium, cannot be solved by an invisible hand within the socio-economic framework. If no social or fiscal policy is adopted, the rich will get richer and the poor poorer with a far reaching repercussion on the stability of the whole society. The Classicists' fear that any redistribution of income would result in the multiplication of the problem of poverty, because it would raise the marginal cost,<sup>1</sup> was refuted by the Keynesians. "If fiscal policy is used as a deliberate instrument for the more equal distribution", declared Keynes, "its effect in increasing the propensity to consume, is, of course, all the greater".<sup>2</sup> This is so. The propensity to consume in the low income groups is much higher than amongst the high income groups. The amount of income which might possibly be left idle in the hands of the rich would, most probably, enter immediately into consumption, if it were given to the poor. The rise in the propensity to consume may also prove to be "positively favourable to the growth of capital".<sup>3</sup>

Assuming that the consumption function has an elasticity of less than unity, the rate of consumption would absolutely decrease as income increases.<sup>4</sup> The imposition of a progressive tax in a community where incomes are unequally distributed would reduce consumption, vis a vis, welfare by less than the state when the same amount is paid by a

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1. Wicksteed, op. cit. p. 636

2. Keynes, J.M: The General Theory of Employment, p. 95

3. Ibid, p. 373

4. Hubbard, J.C: Creation of Income by Taxation, p. 44

proportional tax. The more unequal the distribution of income, the larger is the initial income increment as a result of a given tax falling only on the rich.<sup>1</sup> The smaller the proportion received by the rich the larger will be the rate of the multiplier or vice versa.

But taxing the rich is not in itself an 'income-creating' phenomenon. It depends on State policy towards expenditure and the behaviour of income groups in the economic field. When the revenue received is spent, there is a transference of consumption from one group to another. When the taxes collected are hoarded, in a kind of reserve fund, there exists a case of 'income destruction'.<sup>2</sup> But when they are used to employ idle resources there will be an 'income creation'. Moreover, if the rate of consumption is high and excess income is largely invested as in the case of Britain, a very steeply progressive income tax would impinge not only upon income increment but also upon private investment. If the rate of consumption is low, and most of the income increment is either hoarded or spent on goods and services with doubtful, if not negative utility<sup>3</sup> to the community, as is the case in Egypt, the more steep the rate of taxation is, the more will be the multiplier.

Some would argue that to remove inequality of income, direct policy attack should be made on the reasons for such inequality. The root of the evil lies with inequality of opportunity, inequality of inherited wealth, monopoly obstacles against freedom of access to the market,

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1. Ibid, p. 107

2. Ibid, p. 98

3. If one can consider the utility of expenditure on drink, gambling and unsocial functions as very small or negative.

and non-liquidity of the factors of production.<sup>1</sup> Observations have shown that the distribution of income through the factors of production and by income classes needs a comparatively long time to be altered.<sup>2</sup> The objections raised against a corrective tax, are based on: (1) the economic and psychological supposition that a punitive levy discourages the incentive to work and enterprise and puts a premium on evasion,<sup>3</sup> (2) the social understanding that such a policy is partial and assumes the unproved superiority of the behaviour of certain sections of the people over others which would eventually result not in bridging the gap between the existing classes but in widening it;<sup>4</sup> (3) the political viewpoint that it is not the rôle of the State to be the master of ideology but to be a servant of citizens, initiated to assure their security and further their welfare with the least possible interference.

In spite of all the controversy there is wide agreement in a democracy that a certain minimum standard of living should be attained and that equalisation could be tried up to a point so as not to destroy the differences which are due to natural ability and vocation,<sup>5</sup> or to let the productivity of the community deteriorate. Besides, if we wish to remove the obstructing bureaucratic controls and achieve an equitable monetary and pricing system, argues Meade, "it is necessary to take radical measures to ensure a tolerably equitable distribution of income and property."<sup>6</sup>

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1. Marshall, A: Principles, p. 23, Memories p. 9, Wicksteed op. cit. pp. 636-7 and Dalton op. cit. p. 10

2. Hicks, J.R: Theory of Wages pp. 127-31

3. Hicks, U.K: Public Finance, pp. 231-2

4. Croome, H: Liberty, Equality and Full Employment. Lloyds Bank Review, July 1949, pp. 14-32

5. Green, A.R: Social Reconstruction by the Regulation of Income. Economic Journal Vol. 52, 1942, pp. 37-44

6. Meade, J.E: Planning and Price Mechanism, p. 35

a. Income taxation and the redistribution of income in Britain:

Since the inter-war period, radical steps have been taken in Britain, and in less degree in France, towards achieving a kind of equitable distribution of income through taxation and public expenditure. After the last war a very steep progressive taxation was applied in Britain, accompanied by a wide scheme of social security and welfare allowances. This policy reduced the relative spread in the distribution of income and improved the comparative position of the low income groups. In 1949-50, the income groups over £20,000 retained less than 14% of their income while the income group ranging between £135 - £250 retained about 98% of theirs, before counting the various indivisible benefits, which they received in the shape of health services, food subsidies, child allowances, and the like.

The curve of income distribution is becoming flatter by the narrowing of the gap between the income groups, as one can observe in the following table.

Distribution of income according to ranges of income

Range of Income	No. of Incomes		Amount of Income		Proportion of Income	
	Before Tax	After Tax	Before Tax	After Tax	Before Tax	After Tax
	in 1000	Tax	£ M		%	Tax
135-250	6953	7647	1522.6	1481.2	18.3	20.6
250-500	9290	9470	3551.1	3349.5	42.8	46.5
500-1000	2972	2460	1890.3	1608.3	22.8	22.3
1000-2000	600	384.8	753.9	523.0	9.1	7.3
2000 and over	235	88.2	582.1	240.0	7.0	3.3
Total	20,050	20,050	8300	7202	100	100

Source: Inland Revenue Report, 1951, Cmd. 8436, p. 117

The repercussion of such a system of squeezing the number of high income groups and soaking their income is the reduction in the rate of



accumulation of wealth and the unavoidable curtailment of future receipts from capital taxes and the excess levy on unearned incomes. With every decrease in the revenue from the high income groups the sliding scale of taxation should be reset to compensate for such a loss by directly taxing the groups which are already exempt or indirectly through consumption taxes. This may explain the decrease of those entirely relieved of taxation from 6 millions in 1937-8 to 5 millions in 1950 and the increase of the 'actual income' subject to taxation under Sch. E from £1694 M. to £6885 M.<sup>1</sup> The trend towards the equalisation of income explains also the emphasis given to the indirect taxes and the insistence of the Chancellor of the Exchequer on retaining the purchase tax which was thought to be a temporary measure.

With only 60 receiving an average net income of £8333 in Britain one cannot expect much to be saved. The structure of society is bound to change and the diversion from risk-taking and the reliance on routine work to become the fashion. This is already reflected in the Stock Exchange where Government securities are taking the place of individual ones. In 1950 the nominal value of the former was 64% compared with only 35% in 1939.<sup>2</sup>

It is feared that the continuation of the equalising process and the limitation of income earning might depress the incentive to work hard and might limit the gains which could be realised from the division

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1. While the minimum allowance increased from £125 to £135 in the same period, yet the cost of living increased between the dates from 57 to 115, (1948 = 100). See International Financial Statistics and Inland Revenue Reports 1947 and 1951.
  2. Wincott, H: The Equity in Eclipse, Lloyd's Bank Review, April 1951, p. 43.

of labour. One cannot rely on the super-humanity of the taxpayer, who must have a certain amount of stimulation to function effectively.

The motive to acquire wealth is considered an indication of successful achievement,<sup>1</sup> and should not be destroyed. It is a noble emulation, the gain which originates in competition, as it demonstrates the best quality and energy of human nature aiming at the public good and not at individual selfishness.<sup>2</sup> If the process of destroying the acquisitive and profit motive goes on, "the businessman's time-horizon shrinks, roughly, to his life expectation".<sup>3</sup> He will be less willing to fulfil the function of earning, saving and investing, and will drift into an anti-saving frame of mind. The direct aim towards equality should be to rid the community first of the social waste due to inequalities of distribution. After achieving such an end, it will be for the people to decide through the ballot-box what kind of alternate goods they want to have.<sup>4</sup>

#### b. Income taxation and the redistribution of income in Egypt.

In the case of Egypt the position is completely different. Income taxes are not designed from the beginning to serve as a weapon for redistribution of income and wealth. They were imposed by a vague criterion of ability to pay, leaving enough room for the rich to escape paying even their legitimate share to maintain public needs. The existing state of affairs gives the impression that it is deliberately

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1. Marshall, A: Principles, p. 331

2. Ibid, pp. 6 - 14

3. Schumpeter, J.A: Capitalism, Socialism and Democracy, p. 161

4. Meade, op. cit. p. 38

planned to make the rich richer and the poor poorer. One dare not discuss the defects of the extreme inequality in Egypt or how taxation should be implemented to achieve some kind of equality, because any criticism of the socio-economic order is considered a crime.

In spite of that, fear of the growing tension and possible uprising has forced the Government to relax somewhat its rigid policy. The rates of income taxes are raised to keep pace with the mounting outlay taxes. But taxes of 14% on the under-estimated rental value of land, 16% on income from profit, 10% on liberal earnings and a progressive tax ranging from 8% to 70% on the general income, are not sufficient to plug the gap between the income classes.<sup>1</sup> The margin between the average wage of £1. 10. 0 per week of 51 hours in industry<sup>2</sup> and incomes of over £150,000 a year<sup>3</sup> is so great as to create a kind of disequilibrium in the economic, social and political fields.<sup>4</sup>

The proportion of profits and interest out of the national income is increasing. It reached 40% in 1945 compared with an average of

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1. The estimated revenue from income taxes in 1951-2 is ££48.6 m. and the outlay taxes is ££111.3 m. compared with ££7 m. and ££18.7 m. respectively being their actual yield in 1938-9. See The National Bank of Egypt, Economic Bulletin, op. cit. pp. 280-1 and the Pocket Book of Statistics, Egypt, 1949.
  2. The Pocket Book of Statistics, pp. 118-9
  3. This amount being the reported income of some of the commercial and industrial magnates. It was not exceptional to find one individual holding 30 directorships and 21 had more than 10 directorships in 1941. El-Gritly, A.A.I: The Structure of Modern Industry in Egypt. Published in L'Egypte Contemporaine, 1947, p. 411.
  4. Income differences in agriculture are even greater for the labourer may get a minimum of three shillings a day for a period less than a full year, while a landlord may get as much as £250,000 for renting his land.

36.5%, according to Anis's calculations.<sup>1</sup> At a state of nearly full employment with the majority of the people workers, the proportion of salaries and wages was only 36.8% in 1945. The tremendous increase in profits of two leading banks between 1938 and 1951 gives an idea of the widening gap between the income groups. The net profits of the National Bank of Egypt and Bank Misr (their shared capital is ££ 4 m) increased from ££587,000 in 1938 to ££1,525,000 in 1951.<sup>2</sup> In the meantime the increase in wages could not even cope with the mounting cost of living.

The main drive behind the fiscal measures is the swelling of the class of civil servants. The estimated expenditure on salaries and wages in the Budgetary year 1951-2 is ££49.3 m, being about 22% of the total estimated revenue of that year. This amount is about 31% more than the total State revenue in 1938. The wisdom of this policy of civil service expansion is often debated but successive Governments which come to power have declined for political reasons to alter it.

c. Income taxation and the redistribution of income in France:

There is little indication that income taxation in France will be employed for income redistribution. Such a policy if it were adopted would not find much support among French people, perhaps because the mass of the population is middle-class and not proletarian and their

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1. Anis, M.A: The National Income Output and Expenditure of Egypt, Ph.D. Thesis, London.
  2. The official figure of the cost of living was 322 (1939 = 100) in October 1951; at the same time, the average weekly wage increased by less than three times. See. N.B.E. Economic Bulletin, op. cit. The Pocket Book of Statistics and Issawi, op. cit. p. 93



interests lie in restricting State interference in their affairs.<sup>1</sup>

The political instability and the quick shifts of Governments from right to left and centre parties could not be expected to lead to income taxation being directed from its main object, which is to supply revenue. It seemed possible only in the short interval following the last war when the leftist groups planned their policy on equalisation of income and capital levies.

The welfare state is based mainly on employers' contributions for social security and the budget deficit. The fact that employers pay about 29% of their basic wages' bill<sup>2</sup> tends to increase the cost of production, a result which does not improve the conditions of the workers in the long run. The deficit budgeting and the reliance on loans free of tax undermine any intentional flattening of income distribution. The welfare benefits do not even increase with the decrease of income. On the contrary, up to the limit of 408,000 frs. or £416 a year, certain benefits are calculated on a proportion of the individual's income, such benefits as old age pensions, sick leave and maternity allowances and death grants.<sup>3</sup>

The application of progressive taxation has, no doubt, a redistributive effect but in a much less degree than in Britain. The high income groups, earning over 1.5 m. frs. retained in 1946 about 63.5% of their income and the very low income groups earning up to

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1. Haney, L.H: History of Economic Thought, p. 602

2. The Economist, 22.3.52, p. 736

3. Ibid.



20,000 frs. retained 96.4%. The main income group whose incomes ranged between 20,000 frs. and 150,000 frs. and contributed 77% of the taxable income, retained 95.4% of their income after the tax. Their comparative position was slightly increased by the tax as their income became 79% of the net aggregate.<sup>1</sup> The relative position of the taxpayer; before and after the tax does not change markedly between 1938 and 1946, the the two years of comparison analysed by Brochier.<sup>2</sup> No recent data are available to show if the new measures since 1948 have altered that position; but the impression one gets from the 'new' reform indicates that it is still the same.

Moreover, it is of great importance to study the distribution of income as a whole, not only the taxable part, in order to understand the position of different income groups since some types of income are either exempt or under-taxed. It is also of great importance to assess the degree of evasion to evaluate the equity of any redistribution criterion in income taxation.

### III. Tax Evasion

What is meant here by evasion is the act of depriving the State of the sums it ought to receive according to law. By evasion, the taxpayers pay less than they are liable for, thus upsetting the distribution of taxation, and increasing in consequence, the burdens of conscientious taxpayers. The more widespread the evasion, the more is required from taxation, a matter which is very clear in Egypt and France; and as

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1. Brochier, op. cit. p. 45

2. Ibid, pp. 44-6

evasion corresponds to the rate of taxation, the more the resulting evasion, the greater the inequality in tax distribution and so on, in a vicious spiral. Apart from the non-payment of tax through legal or illegal means, the intentional delay in paying taxes can also be considered as a form of evasion,<sup>1</sup> and its serious effects are mostly felt when the value of money falls over a continued period.

The problem of evasion is very complicated, and discovering its cause is a step towards removing it. One has to go to the mind of the tax evader; his action is not exactly an indirect robbery or indirect defrauding of individuals,<sup>2</sup> provided we agree that our actions are not absolute, and honesty and dishonesty are different degrees of one thing. When a taxpayer evades or intends to evade his tax liability, he usually does so with the sense that he is acting properly and with self-justification. The taxpayer, on being asked to declare his returns, will be in the position to judge for himself what is the just share that he has to contribute for public purposes. His behaviour is mostly conditioned by his attitude towards the real meaning of his 'returns' and what the terms 'State', 'taxation', and 'public purposes' convey to him. The taxpayer is a human, social organism, and fundamentally different from a machine,<sup>3</sup> and he can never act exactly as the State requires him to act. The imposition of a tax reducing his purchasing power, and of necessity probing into what he feels is his privacy, has a reaction upon him which differs according to his position and character.

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1. Tranter, A.V: Evasion of Taxation, p. 5.

2. Ibid, p. 19

3. Joad, C.E.M: Guide to Modern Thought, p. 21

A tax may be imposed on the taxpayer against his consent, he may consider it a means of oppression and a method of enslaving him, therefore he resists it through fraud, and with force, if he considers that the imposition is unjust. On the other hand, he may agree with the principle of taxation, but disagree with the method of expenditure by the State, thus he tries to evade the tax which may be wasted, or which, in expenditure does not profit him directly or indirectly.<sup>1</sup> In such cases the remedies against evasion lie in embodying real representation of the taxpayers, with powers to legislate for taxation and plan expenditure and supervise both.

The writer was not surprised, when investigating tax evasion in Egypt, on questioning a number of taxpayers, to find that nearly all of them justify evasion for the already mentioned reasons. In some cases it was found that the taxpayer evaded tax because he found others doing so, or to show his intelligence and cleverness against the tax collectors. Similarly, a taxpayer persuades himself by the convenient illogicality that since he is not richer than the State, what he is asked to pay is a negligible addition and that his evasion will do no harm. His duty to the State is not developed to the extent that it could combat his tendencies to evasion.<sup>2</sup> Evasion, as has been mentioned, is a

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1. In a reported speech by N. Tranter, a Scottish Nationalist complained that Scotland is not getting her fair share in Government expenditure and advocated the withholding of income tax payments to ensure fairer treatment for Scotland in such spending.  
Scot. Daily Mail, 19.4.1952.

2. Stamp, op. cit. p. 104

psychological as well as an economic condition;<sup>1</sup> it increases or diminishes according to the change in these two factors, but there is no evidence that race is a factor affecting the rate of evasion. No confirmation is forthcoming of Formery's assertion the tax evasion in Mediterranean countries is higher than in other countries;<sup>2</sup> but association could, however, be found between the kind of government and the degree of evasion.

We shall never reach a state of zero evasion unless each taxpayer owes a concrete allegiance to the system of government, the system of taxation, and the ways of State expenditure. One has to impress upon the taxpayer his responsibilities and the burden he and others must carry. Teaching and propaganda can hardly affect conditions as they stand; however, by considering equity in imposing and collecting the taxes, by removing any kind of corruption in the State departments, by giving the taxpayer the right to suggest and amend the taxes, and by spending the public revenue wisely to achieve the maximum social advantage, much can be done in this direction. Punitive and severe acts against fraud<sup>3</sup> do not check it completely; they may lessen it, but on the other hand, they may be calculated to do more harm than good, and increase the social cost of the tax.

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1. Formery, op. cit. pp. 83-4

2. Laufenburger, *Finances Comparees*, pp. 196-197

3. As early as the twenty-sixth dynasty of Ancient Egypt it was enacted that men who failed to make an annual declaration of their means of subsistence would be liable to be executed. See Tranter, op. cit. pp. IX and X

a. Tax evasion in Britain:

In Britain the civic sense of the people is very high and the degree of evasion seems to be small in spite of the excessive rate of taxation. The response of the people to the appeals of the Chancellors of the Exchequer during the crises of the last two wars reveals this fact. In his Financial Statement of April 23, 1940, Sir John Simon paid a tribute to the taxpayers who "have behaved nobly in paying up so promptly the increased sums demanded of them". Even those of quite modest incomes who were in need of every penny of it and whose sacrifice in paying was comparatively high "made a very special effort with the first request for payment".<sup>1</sup> This high sense of responsibility cannot be forced upon people, but their response to it is largely related to their belief that what they pay is honestly spent for their common interest and welfare.

But no Government can depend solely on the civic sense of its people however high for the payment of taxation, because one must remember that paying taxation is quite contrary to the profit urge. The Revolutionary Government of France received only one-half of the taxes due in 1792 when the department of tax collection was closed.<sup>2</sup> A high civic sense can be utilised to facilitate the job of an efficient and honest machine of tax collection, but not to supersede it. Britain acquired this efficient machine after long years of trial and error.

The British Tax Commissioners have a wide power to investigate all

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1. Hansard, Vol. 360, 1939-40, p. 52

2. Allix, op. cit. p. 86



accounting books, and bank accounts and to check on property transference through inheritance or otherwise to find out if any taxable income has leaked out. Any person who is found fraudulently evading the tax through the refusal to submit sufficient accounts of his income from all sources, forfeits a sum of £20 and pays a treble amount of the tax which he ought to be charged under the law.<sup>1</sup>

The assessment of tax evasion is a matter of guess work and the margin of error is bound to be great. It was estimated before World War I that the amount of income evading the tax ranged between £37 m. and £75 m.<sup>2</sup> In 1949 a member of Parliament alleged that income tax evasion could be put at £100 m. a year, a figure which was refuted by the Financial Secretary.<sup>3</sup> In May, 1949, the Board of Inland Revenue appointed a Departmental Committee to examine the outstanding balances of Inland Revenue duties, to analyse their causes and to ascertain what steps could be taken to reduce them.<sup>4</sup> The Committee disclosed that £588 m. out of the total balance of £675 m. in 1949 were non-collectible arrears.<sup>5</sup> These arrears cannot be counted as evaded but rather as unsettled liabilities. Some of these liabilities are related to unsettled terminal allowances, are based on unascertainable assessments, or are due to differences about the interpretation of the law or to arguments about the facts, and so on.

In 1951, the drive against under-assessment and other sorts of

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1. Draft, Income Tax Consolidation Bill, pp. 12 and 15

2. Tranter, pp. 23-5

3. The Economist, 19.11.1949

4. Inland Revenue Report, 1950 Cmd. 8103, p.12

5. Inland Revenue Report, 1951, Cmd. 8436, p. 17

tax evasion resulted in raising about £7.5 m. including the penalties imposed, which is a very small proportion of the tax collected (less than 0.4%). Most of the evaders were small traders whose sense of objection to income tax is very strong. Such people feel that taxation impinges upon their legitimate earnings and that they are justified in under-estimating their income or in deliberately failing to submit any declarations. On the whole one cannot consider tax evasion a real problem in Britain, if not because of the small rate of evasion, then because the excess profits taxes and the death duties absorb most of the money unremitted for income taxation.

b. Tax evasion in Egypt:

In Egypt, fraud and tax evasion are rampant.<sup>1</sup> The people as yet are not taxation-conscious, and this defect accompanied by their hazy understanding of the conception of the State contributes to the widespread evasion. When the Schedular income taxes were imposed, the Government took little pains to explain the fiscal change to the people, but was merely satisfied in promulgating the law. The tax regulations, for some unexplicable reason, were kept semi-confidential and the Ministers of Finance, from time to time, made changes in the law, often in an unconstitutional manner, confusing not only the taxpayers, but also the tax collectors; in some of these instances, the

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1. The amount of tax evasion is estimated in April 1952 to range between £100 m. and £150 m. since the Schedular Taxes were first imposed. The aggregate revenue from all income taxes between 1939 and 1950 was only £120 m.

'new' regulations were given a retrospective power.<sup>1</sup> It is not strange, therefore, that a large number of taxpayers did not pay their share. In some cases, the lack of definition on some points of the law were also responsible for evasion, as it is natural that the taxpayer always interprets the more obscure regulations to his own advantage. This kind of non-deliberate evasion is by no means disturbing, as it can be remedied by fiscally educating the people.

Another psychological reason for the widespread evasion, which took place during the last war, was the desire for easy and quick enrichment. Such a pressing desire, accompanied by the understanding that no one was obliged to conceal the means by which he produced his wealth, has driven a large number of taxpayers to fraudulent evasion. The allegiance of these people to society is weak, and the politico-social conditions cannot stir their conscience to a sense of the gravity of their behaviour. The Government in its turn has not met this sweeping tendency by the swift measures needed, such as intensifying the investigation of the taxpayers accounts or imposing an enrichment tax after the war. A standing order prevented any individual from getting an exit visa from the country before submitting a declaration from the Taxation Department that he had paid all the taxes due. This order seems to have been ineffective; it was only applicable when such an exit visa was necessary to leave the country. Even then some big taxpayers escaped the net and managed to slip out without their tax

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1. The Audit Department Report on the Financial Accounts of the Year 1945-6, Egypt.

bills ever having been paid.<sup>1</sup>

What is a rather alarming and obviously flagrant kind of evasion is the reported process of writing off all the tax arrears due from any company when it is Egyptianized. This is an exploitation of the nationalist feeling which insists on increasing the Egyptian share in foreign companies and only means a transference of money from the State to the wealthy section of the people.

The worst kind of evasion from which the country is suffering, is that carried out through political influence. Such a high-handed attitude, which the writer met with during his experience in the Taxation Department ten years ago, aggravates the inequality of an already, existing unequal tax distribution. Successive Governments have never tackled these problems and, indeed, have often used the income tax as a punitive weapon against their opponents. The unavoidable effect of such abuses on the tax-collector himself is calculated often to render him unfit to pursue his work impartially and fearlessly.

To combat tax evasion which arose through other means, the Government is satisfied with some administrative and punitive measures which show little success. These measures can be simplified as follows: (1) the time after which the right of the State to claim the unpaid tax expires was extended from five to eight and then to ten years; there is a great reluctance to approve a suggestion made by

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1. In a reported case a 'Cabaret' owner left the country without a tax on accumulated profits of about £E500,000. Another 'Café-Bar' Proprietor disappeared paying no tax on about £E50,000.

the Taxation Department that such a right should be extended to an indefinite period; (2) the fines for any contravention of the provisions of the law were increased to £50 and an amount ranging between one-quarter of and three times the amount of tax evaded; (3) the amount of bonuses for employees was fixed at a maximum of two months pay;<sup>1</sup> the special remuneration granted to the appointed directors of the joint stock companies is fixed at £3000 per annum for each director which should not exceed two;<sup>2</sup> and the expenditure allowed for charitable and other benevolent societies is restricted to a maximum of 3% of the net profit of the concern; (4) the practice of not using taxpayers' account books and documents as evidence against evasion on the part of another taxpayer was terminated in 1951.

During the war, the pressing need for revenue compelled the Government, instead of going through the tedious process of passing a law, to issue a Military Proclamation, No. 361, of 1942, fixing the period of the presentation of the declarations relating to the commercial and industrial profits tax, E.P.T. and demanding the payment of the taxes due. The Proclamation penalised any contravention by an imprisonment of three months and/or a fine of £100 for the supply of any false indications in the declarations and other presented documents, in addition to a fine equal to three times the unpaid tax. This measure proved to be effective, for the revenue collected from E.P.T.

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1. In one case the writer was told by one of the Taxation Department principals that a company which tried to evade the E.P.T. had granted an employee, in one year, a bonus equivalent to 10 years pay.
  2. Payments to companies' appointed directors are subject to the tax on salaries which is lower than the tax on moveable property.



increased from ££0.6 m. in 1941-2 to ££5.5 m. in 1942-3 and to ££6.5 m. the following year. Moreover, the yield of the tax on commercial and industrial profits increased from ££1.1 m. to ££3 m. and to ££4 m. respectively.

This improvement does not imply that all the taxes due were paid, but, rather, the amounts represent the liability of most of those who were known to the Taxation Department and so could not avoid payment. An investigation carried out by that Department in July, 1943, showed that the above-mentioned Proclamation was not only successful in lessening tax evasion but also that it helped to lessen the lag of tax payment. It was found, for instance, in Alexandria (the second important commercial and industrial centre), that those who presented their declarations for commercial and industrial profits tax numbered 22,500 and those who presented them because of the former measure amounted to another 12,340, whilst those who paid according to their declarations numbered 7100 compared with a further 3970 who paid under the obligation of the decree.<sup>1</sup>

The wide-scale evasion in Egypt results in a maldistribution of the tax burden, penalising the most conscientious people and those who were liable to pay at source. It is feared that even this minority might succumb to evasion unless a quick remedy is forthcoming. The number of tax-collectors has had to be increased but their specialised training

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1. Taxation Department Investigation about the effectiveness of the Military Proclamation of 1942.

in finance and taxation still leaves room for improvement. It may be urged that failure to submit return statements and to pay any administrative additional expenses increased by such action, as well as the interest to offset loss of interest.<sup>1</sup> This last point is important especially in periods of inflation when the delay in tax payment contributes to the increase in the rate of inflation. Transfer of any foreigner's wealth from the country as well as his personal departure should not be permitted before evidence that his taxation liability is cleared.<sup>2</sup>

Investigations should be made about the increment in the wealth of 'suspected' people especially since the war. The recent law giving the State the right to confiscate all illicit profits resulting from the misuse of Government posts might be applied to other tax evaders. If, for any reason, such an action cannot be taken, a special tax on the increment of wealth since the war should be imposed. Moreover, the exclusion of fraudulent evaders from Government tenders may prove very effective. They can also be denied facilities of import and export licenses as well as any Government subsidy.

c. Tax evasion in France:

Tax evasion in France creates moral, political and penal problems of grave concern.<sup>3</sup> To the Ministers of Finance it presents an awkward problem of first magnitude. Fraudulent evasion is like cancer deep-rooted in French fiscal structure. According to Bareau, the attitude of the French citizen towards his Government has been tainted from time

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1. Tranter, op. cit. pp. 89 and 171-182

2. Ibid, p. 89

3. Laufenburger, op. cit. p. 198

immemorial by certain grudges and suspicion which are reflected in his conscious attempt to evade his responsibilities and defraud the revenue departments.<sup>1</sup> In spite of Formery's and Laufenburger's<sup>2</sup> attempts to treat the problem in isolation and pick out some parts of the country as less willing to defraud compared with others, yet the inherent cause for such a wide-scale evasion is not in the people themselves but in the tax structure and other politico-social and economic defects in the community.

We have noticed before how the French system, like its Egyptian counterpart, is based on favouritism and inequality in distributing the tax burden, and how France is politically, economically and even socially unstable. The increasing resistance of the public to pay the tax is also influenced by twisted thinking in praising the intelligence of the evaders.<sup>3</sup> All these factors have their repercussion in rendering the problem more dominant.

No accurate estimates are given to explain the degree of tax evasion. Hinting at the problem, Laufenburger gave the number of electorates and the taxpayers in different areas;<sup>4</sup> but such figures cannot indicate the degree of evasion unless the tax is imposed on each person. The under-estimation of the income of some classes of taxpayers is clear and may give an impression of the degree of evasion.

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1. Bareau, op. cit.

2. Formery, op. cit. pp. 83 et seq. and Laufenburger Traite, op. cit. p. 291

3. Laufenburger, Finances Comparees, p. 197.

4. Laufenburger, Traite, p. 285

In 1944, only 165 physicians, dentists and advocates were enlisted as having incomes over 500,000 frs., and only 1473 were enrolled in the category of 200,000 to 500,000 frs.<sup>1</sup> In the whole of France only 429 taxpayers were tabled as earning over one million francs.<sup>2</sup> The amount of evasion can be assessed from past experience. In 1923 it was estimated in one case by the present President of the Republic that less than one quarter of the returns from securities were declared for tax payment.<sup>3</sup>

The penalties against fraudulent evasion are comparable with and even more severe than those applied in Britain. Before 1948 the penalties were somewhat lenient. Inexactness in the documents presented to the Taxation Department was penalised by doubling the tax on the omitted amount, providing it did not exceed one-tenth of the taxable amount or 20,000 frs. If the evaded amount was less than that, the fine ranged between 1000 frs. and 5000 frs. Since 1948, any fictitious entries in the accounting books in order to defraud the Taxation Department is penalised by a fine ranging between 10,000 frs. and 2 m. frs. and by six months imprisonment.<sup>4</sup> But it does not seem that such penalties succeeded in stopping this mass tax evasion.

In an attempt to solve this harrassing problem, the present Government of Pinay has passed a law giving amnesty to past tax-dodgers.

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1. Ibid, p. 285

2. The exchange rate at that time was considered as relatively high was 200 frs. for £.

3. Tranter, op. cit. p. 30

4. Memento Fiscal, p. 21

The amnesty is granted for all offences committed before January 1, 1952, unless the frauds have already been detected. If they avail themselves of this privilege, the taxpayers are given until May 5, to correct their declarations submitted to the Taxation Department. It is made clear that in the interests of defrauders it is important to give proof that it includes all the wealth they have acquired before July 1; otherwise they may be prosecuted on the ground that such wealth was realised after the granting of the amnesty.<sup>1</sup>

This measure may give the Government a rough idea as to the extent of fraudulent evasion, in what ways it is usually conducted and by what section of taxpayers it is usually practiced. According to such an investigation the Government might be able to build its future policy on a more concrete basis. The immediate reaction of issuing the law is the sharp recovery in the gold and foreign currencies on the Paris Exchange. Its reaction on income tax returns remains to be seen.

From past experience of French reaction towards fiscal measures, the amnesty law does not seem to have much success as it does not cope with the main evil deeply rooted in the politico-social and economic structure. Fraudulent evasion is a crime not against the Government as such, but against the whole community, threatening its foundation, and it has to be dealt with accordingly. Amnesty to tax-dodgers is morally and socially objectionable. It offends the salaried workers

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1. Daily Telegraph report 18.4.1952



who pay their tax in full and benefits the non-salaried who do not meet their obligations. Such a measure penalises the honest and conscientious taxpayers, and there is no proof that tax-dodgers will refrain from behaving in the old way in the future. The French fiscal problem can be solved if the political and social problems are tackled and the taxation structure is purified.

An easy target for evasion is the income obtained from foreign investment and belonging to taxable individuals within the country. But such evasion is not so alarming that it cannot be met by bilateral conventions. In the Anglo-French agreement of December 14, 1950, it was agreed that the taxation authorities of the contracting parties can exchange information at their disposal for the purpose of preventing fraud and evasion in relation to the taxes which are subject to the convention.<sup>1</sup>

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1. U.N.O. International Tax Agreements, Vol. II, p. 120

CONCLUSION

From the previous study one may accept the idea that income taxation reflects the economic conditions which prevail in a country and the dominant politico-social forces within a certain period. When the internal components are at equilibrium one can expect the existence of an equitable tax system. It is doubtful whether any practical tax formula, however ideal, can solve our social evils and construct an equitable income distribution before dealing directly with the politico-social forces which influence them. It is quite obvious that one cannot expect to have a good taxation system before having a good Government. The natural order demands putting the wagon in front of the horse and not the opposite. The development of a taxation system towards achieving a just distribution of common needs is the result of politico-social changes; but tax formulae in themselves can never determine the social framework of a community.

Taxation cannot be treated in a vacuum or isolated from other measures of State expenditure and the manner in which price mechanism works. The point is not to impose a tax but how it is conducted, and to what extent it is levied to serve the needs of the community and to achieve a maximum social advantage and not to benefit a particular section of the people. The taxpayers will be more willing to contribute if the impost is intended to meet a common end than if it is destined to satisfy only a part of the community. Moreover, the value of what is left to the taxpayer is as important to him as the tax itself, for the value of

the residue indicates to him the value of his work and enterprise. Any limitation of the individual freedom to use the part of income left after taxation is also equivalent to an excess tax on him.

According to the view that any taxation system is an outcome of the prevailing conditions in a certain country at a certain time, the copying of any country's taxation system by another may not be helpful and may rather be disastrous. But it is of great importance when looking at any kind of tax reform to examine the effect of certain tax formulae on similar conditions in another country. A certain rate of taxation on a highly efficient industry as that of Britain's will have much less repercussion on the structure of industry than the same rate on a less efficient industry or in a country seeking some kind of industrialisation, as is the case of Egypt. Also, the imposition of a certain tax on income derived from agriculture in a country short of foodstuffs and raw materials and finding difficulty in the world market of getting them in exchange for its industrial products, will have a strenuous effect on the economy of that country, far more serious than a similar tax imposed in a country producing more than its needs and finding difficulty in selling them. In the same manner the imposition of a high tax on the part of income which is used to increase the accumulation of idle balances, or destined for expenditure of doubtful or small utility to the community, in a country suffering from unemployment or short of capital investment, can be considered as "income creative", while in a country in a state of full employment such high

taxation may be "income-destructive". Thus policy to reform income taxation will differ in Britain, Egypt and France, as their politico-social and economic structures are different and their needs are different too. But the study has clarified our ideas as to the varied slips and loopholes in the income taxation systems of the three countries and their degree of success in coping with and their flexibility in dealing with ever-rising problems.

In Britain, the novelty of using income taxation for the equalisation of income has nearly gone. With the closing of the gap between social classes, taxation policy should have different directions. It is becoming of little importance and hardly beneficial to the British community with such a high rate which leaves 2.5% out of any amount of income gained after a certain figure. The number of very high income earners is decreasing rapidly and the amount of taxation exacted from them is comparatively small. In spite of that the steeply increasing rate has a psychological reaction depressing on the incentive to work and increasing socio-economic irritation and instability.

What seems to be worrying the labour section of the community is the possibility of unemployment rather than the existence of some people earning high incomes. So long as such high incomes do not interfere with the state of full employment and no obstacles are erected against their rising in society there is little reason to suggest that the labouring class will insist on equalisation of income as an end in itself.

The two main problems facing Britain are insuring the community against cyclical crises and maintaining an economically balanced state

in such unsettled social and economic conditions of the world. The vast changes which are in process in the international sphere necessitate meeting them with well prepared and fully planned policies rather than insisting on an old system, the reasons for whose continuation have been altered. The problem of unemployment needs a well constructed process, highly productive and capable of facing the challenging competition in the world of to-day. To restore equilibrium to the balance of payments is urgent, too, as the continuation of a deficit means a drain on the country's resources, threatening its economic order.

The importance of encouraging incentives to work and to enterprise is quite obvious. This can hardly be achieved before resetting income taxation in a formula which leaves the individual a reasonable amount worthy of his sacrifice. With income better distributed, and the lower strata at an assured acceptable standard, the need for high progression is less urgent. The productivity of such a steep tax is not so important as was formerly considered. Besides, the rate of taxation as a whole has reached the high water-mark and one cannot expect it to continue without shaking the economic structure in a vicious spiral of cyclical devaluation of the currency. The existing state of affairs urges a reduction in the rate of income taxation to give impetus to the people and to emphasise to them that their excess supply of effort is worth something to continue it.

If such a policy should be adopted the E.P.L. has to be reviewed as it is burdensome to industry and a depressing factor on initiative.

There is a change taking place in the fiscal structure which one



can feel in the insistence of successful Chancellors of the Exchequer on retaining the purchase-tax in spite of its depressing effect. Such a tax may convey points; first, it may be intended to reduce the effective demand of inflated wages; secondly, it may be a redistributing measure of the burden between income and outlay taxes. Whatever the intention, the imposition of a tax on income equal to the amount of a purchase tax would mean a gain in the consumers' surplus, everything being the same. It seems more advantageous to the whole society if the purchase tax is terminated and the income tax rearranged on any of the plans suggested in the last chapter.

The problems of Egypt which could be dealt with through income taxation are quite different than those prevailing in Britain. There exists a wide gap between the Egyptian community's social classes in income, wealth and politico-social power. The pressing need is to bridge such a widening gap. So long as a large part of income is left idle or sunk in unproductive means while the country is suffering from mass unemployment, and the resources are left unutilised, the community will be better off with a very high progressive tax absorbing such idle balances. The expenditure of the revenue from this kind of levy would accelerate the multiplier and push the economic machine to work more effectively.

The taxation system gives unrequited benefits to certain sections and classes of the people and contains a lot of loopholes. There is the overall tax exemption of State securities and the exemption of

agricultural profits which neither justice nor economic rationalism will support. The holders of State securities are income earners who should share in carrying the economic burdens of society, and the land tax which is paid by the landlords does not fulfil the tests of a tax on real income and its incidence is not the same as an income tax.

But to suggest a solution does not mean solving the problem. The position of any social reformer in Egypt is awkward. With power being concentrated in the hands of a minority, the problem is how "a bell can be hung on the cat's neck". The writer has not much hope of radical change in the fiscal structure before the solution of the politico-social problem which dominates and determines the scene.

The problem in France is one of socio-economic disequilibrium and solving it is not so hard as is the case in Egypt. Retaining the balance of the French budget is a matter of great magnitude. It will restore confidence in the people and stabilise the economic order. But balancing the budget cannot be carried out without everyone paying his share and the Government closing the loopholes, and acquiring an efficient taxation machine. The French system is in theory ideal, but in practice a scandal. It cannot be replaced by another based on the British pattern or the fraudulent evasion would be increased.

Again, everyone cannot pay his share and the loopholes be closed without politico-social stability being achieved. With three different

Governments having different shades and policies being in power in the last three months, everyone would no doubt be wondering what might take place in the very near future. This case of political uncertainty contains the symptoms of economic disequilibrium. How this problem can be solved is not in the domain of the writer in economics or public finance but is a matter for the people and their conduct in the ballot box.

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